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TOUGH AS NAILS!

kip the touchy-feely uff. The Big Box tailer is thriving under EO Bob Nardelli's ilitary-style rule

BRIAN GROW (P.50)

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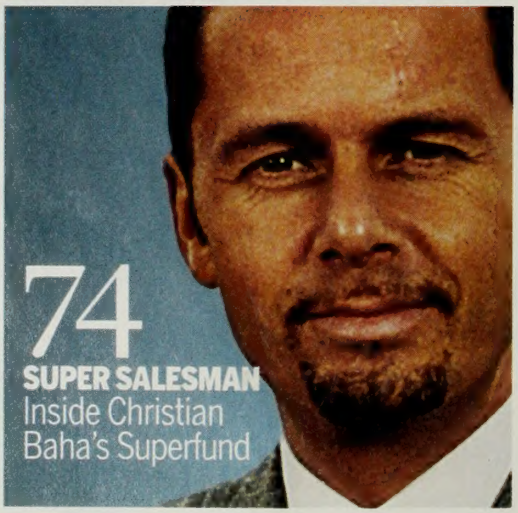
March 6, 2006

50
ORANGE ALERT
Nardelli aims to instill military discipline at the once-sprawling Home Depot. But has morale suffered?

66
VALLEY GIRL
Autodesk's Carol Bartz steps down



74
SUPER SALESMAN
Inside Christian Baha's Superfund

Cover Story

50 Tough as Nails
CEO Bob Nardelli runs Home Depot with a command-and-control structure that might see retro in these days of empowered teams. Som say he's creating a cultu of fear, but his boot-cam methods seem to be working quite nicely, Sir

58 The Depot's Secret Weapon
Its Innovation Center tests the ware before they hit the shelves

The Business Week

30 News You Need to Know
Nigerian tremors; satellite radio red Microsoft's woes in Europe; E.on ey Endesa; and more

News: Analysis & Commentary

32 Here Comes Lunar Power
Tides and waves offer more oomph wind and are more consistent than s

36 Carl Icahn: Improbable Robin Hoo
His new image as the shareholder's friend doesn't jibe with recent move

37 Majority Rule in the Boardroom?
A new round of battles to democrati director elections

38 The Other Club Battering GM
It has too many dealers—and they h as much clout as the UAW

40 The Real Shipping News
Behind the furor over Dubai Ports is well-respected global company

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2 The Key to Google's Success
innovative auction system has ad venues soaring

lobal Business

5 Apostles of Outsourcing
hind the offshoring wave is a network alumni from General Electric and Kinsey

3 The Road Narrows for Hyundai
naway costs and the rising Korean rency are choking profit margins

overnment

Washington Outlook
e asbestos mess: Do the states have a y out?

nformation echnology

Dell vs. the Dell Way
w the PC maker's once-revolutionary es strategy is holding it back

he Corporation

Merck: Out of the Ivory Tower
new strategy includes a plan to turn vitamin niacin into a blockbuster

eople

Autodesk's signing Woman
tgoing CEO Carol rtz has become one ech's most portant women

The Best Performers

From Doghouse to Corner Office
e irascible Carl Bass' route to the top

inance

A New Vision at NYSE
w the groundwork is being laid to ke the exchange a global powerhouse

pecial Report

Welcome to Superfund
ristian Baha's hype-heavy firm has en Europe's average-joe investors by rm. Now he's poised to make a ious run at U.S. investors

92
MONEY BLOGS
The MySpace generation has a new tool for managing finances. And you're welcome to share

82 The Odd Bunch Running Hedge Funds
It's a field that attracts managers with little or no relevant experience

Science & Technology

88 China: A Biotech Dragon Stirs
It's forging ahead in gene therapy as Western companies face tougher regulatory hurdles and safety concerns

91 Developments to Watch
Of batteries and chewing gum; life without the PC mouse; pre-transfusion blood filtering; flesh-eating disease

Personal Business

92 Follow My Money
Young bloggers are documenting their financial lives and even offering advice on how to make a million

94 Mileage from Go-Anywhere Funds
All-caps have their pick of equities and outperform more focused peers

96 Net Stocks: Good Value Hunting
Our Web 20 list adds faster-growing companies with lower valuations

98 If This Furniture Could Talk...
Collectors of 17th century English oak savor its history and its elaborate detail

100 Deck Them Out for the Ball Game
Shopping for your Little Leaguer? Get ready for a dizzying array of gear, and some Big League prices

102 Personal Business Plus
Fine watches for southpaws; rating service contractors across the nation; de-icing frozen pensions; the rise of Ultimate Fighting

Columnists

24 Wildstrom: Technology & You
The new standard for HDTV is dazzling, but there's one big drawback

26 Kiley: Media Centric
A social networking site for car nuts

27 Cooper: Business Outlook
What's heating up the economy? It's more than warm weather
Behind the numbers: A rare January

104 Marcial: Inside Wall Street

112 Bartiromo: Face Time
As the housing market softens, how worried should we be?

Ideas

110 Books
Ormerod: *Why Most Things Fail*

111 BusinessWeek Best-Seller List

114 Outside Shot
Warren Bennis: Lessons from Larry Summers

Voices of Innovation

22 One Talented Techie
How Orbitz founder and serial entrepreneur Alex Zoghlin went from high school dropout to billionaire

Features

13 UpFront
18 Readers Report
20 Corrections & Clarifications
106 Figures of the Week
108 Index of Companies

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JP Front

"He was using Enron like a damn ATM machine."

–Paula Rieker, former Enron managing director of investor relations, recalling in court on Feb. 21 the reaction of an Enron board member to news that Kenneth Lay repaid company loans with Enron stock in 2001

TED BY DAN BEUCKE

HE REAL DEAL

IME WARNER: OOSTERS AT HE GATE

ADVISER TO CARL ICAHN'S n to break up **Time Warner,** ce Wasserstein was all r CEO Richard sons. But now nn has backed (page 36), and sserstein has d reason to be a sons fan. That's unusual nature ne retainer that sserstein's estment bank, **rd,** struck with nn. While most king advisory are a percentage of a deal l on its completion, Lazard 5% of whatever Icahn's up makes from its Time ner shares through May, 2007. Lazard is paid based on the difference between 18 per share and a higher sale price.

That gives Lazard about $6.8 million for every dollar the stock rises above 18. It's now trading at 17.43. Lazard's own Time Warner report estimates that a $20 billion stock repurchase, and $500 million in cost cuts, could boost the stock price more than $2 a share. (Time Warner plans to cut $1 billion.) "Winning was all about enhancing shareholder value," says Douglas Taylor, a Lazard managing director. Of course, Time Warner's stock could tumble. But Icahn agreed when he hired Wasserstein also to pay Lazard $5 million in cash. Icahn couldn't be reached for comment. *–Emily Thornton*

WASSERSTEIN
Cheerleader?

HE BIG PICTURE

L TALK? Despite nagement's focus on ovation, U.S. executives their companies give hort shrift.

T RESPECTED DERSHIP QUALITIES*	CHINA	U.S./ CANADA
ity to take a stand and make tough decisions	7%	7%
ativity or innovation	16	4
ity to bring in the numbers	30	36
personal skills uence, coaching, networking, communication)	5	15
ity to create a strategy or vision for success	7	12
grity or ethics	15	7

ndents were asked to choose only one quality; table doesn't include all options listed
Development Dimensions International Inc.'s 2005 survey of 4,559 corporate managers in 36 industries

PERK PARADE

Pretty Plush Directors' Chairs

SHAREHOLDERS ARE ASKING BOARDS to pay close attention to top executives' compensation. But what's up with board members' pay? In a sampling of 34 companies in the Russell 3000 index that increased directors' pay, compensation research firm **Equilar** reveals that average cash retainers for directors soared 72%, to $44,000, since January, 2005. Those awarded cash and stock retainers gave themselves 39% raises, to $140,000 on average. Equilar conducted the study for *BusinessWeek.*

Many increases far outpace stock price gains. For example, **Nastech Pharmaceutical,** a biotech company in Bothell, Wash., boosted directors' pay by 400%, to $15,000 annually. Last year its stock price rose 22%. Similarly, shareholders of **Compass Minerals International,** a specialty chemical company in Overland Park, Kan., earned a 6% return last year, but directors got $75,000, or 200% more than in 2004. "In order to attract independent directors with the expertise needed for a public company, we needed to more closely match the board compensation of similarly sized companies," explains Compass spokeswoman Peggy Landon. She points out that Compass directors no longer receive meeting fees or options. Nastech declined to comment. *–Emily Thornton*

UP Front

PENSION FUNDS

NO GOOD DEED GOES UNPUNISHED

BEING A SOCIAL advocate does have its costs. California Treasurer Philip Angelides (right) hopes to take on Arnold Schwarzenegger in the state's November gubernatorial election and sits on the board of the state's powerful **California Public Employees' Retirement System.** Angelides had pressed the giant fund to stop investing in countries that don't meet social criteria, such as having a free press and adhering to global labor standards—a popular stance with unions, which are big campaign contributors.

But a report by CalPERS highlights the costs. The restrictions bar powerhouses such as China and Russia. Since the policy was initiated in 2002, emerging-markets investments handled by three managers for CalPERS trailed unrestricted emerging investments made by those same managers for other clients by an annualized 2.1%. On CalPERS' $4.7 billion emerging portfolio, that worked out to $203 million of lost gains. A CalPERS spokeswoman notes the three foreign funds still had annu-

alized gains in the range of 32.4% to 39.8%. "The difference in returns represents a short-term perspective that ignores the real investment risks" in nations that condone abuses, says Angelides spokesman Michael Roth.

–Christopher Palmeri

FLIGHTS OF FANCY

MAYBE FALTERING airlines just need to chann cartoon characters. In October, Taiwan's EVA Air unveiled a Hello Kitty-themed plane for flights between Taipei, Tokyo, and Fukuoka, Japan. The cat's iconic image, licensed by parent company Sanrio, decorates everything from the jet's exterior to its in-flight food, boarding passes, and flight attendants' uniforms. Fans, families, and the merely curious line up for tickets—the plane is booke more than 90% on average. The carrier also does a brisk business in Hello Kitty duty-free goods (some resell on eBay next to pilfered barf bags). Next up: a package tour to Tokyo's Hello Kitty theme park. *–Elizabeth Woy*

BLOGSPOTTING

HEY, PROXY, LOOK ALIVE

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» **WHY READ IT** This governance blog by proxy advice firm Institutional Shareholder Services looks at issues like CEO pay and shareholder activism through the eyes of ISS and outside experts.

» **NOTABLE POST** A study of 5,300 companies finds a strong correlation between improved corporate oversight and market value. Value rose 4% for each trait enhanced, say Reena Aggarwal and Rohan Williamson, professors at the McDonough School of Business at Georgetown University.

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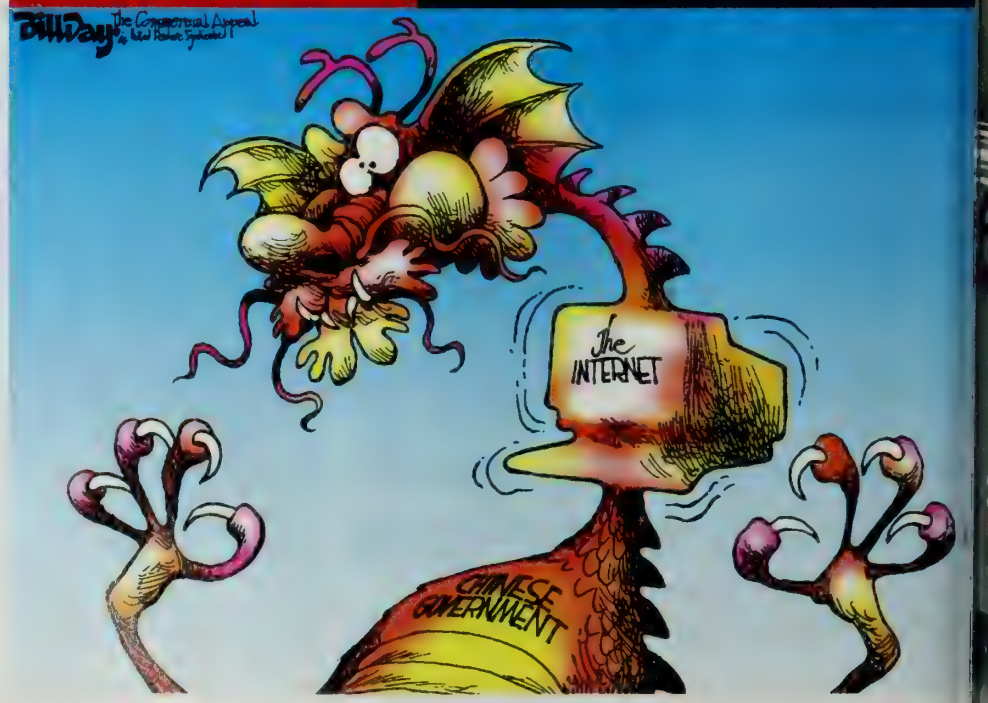

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UPFront

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So you're in Ireland with your golfing buddies when—Holy Emerald Isle!—you score a hole in one. Congrats. Now, if only you had bought travel insurance through Travel Guard International. Then the drinks—which according to golf etiquette are your responsibility—would be covered. The new "Tee, Tour & Travel" policy offered by the Stevens Point (Wis.) insurer reimburses golfers scoring an ace for up to $250 in bar costs at the clubhouse where the hole-in-one occurred.

Travel Guard reserves the right to document the achievement. For liability reasons, it insists drinks are consumed on premises and won't cover an evening of bar-hopping. The policy also covers up to $25,000 in medical expenses, $2,500 for lost, stolen, or damaged golf clubs, plus unreimbursed expenses if a trip is canceled. The cost: slightly under $100 for a $2,000 trip. Travel Guard says it has sold roughly 1,500 policies since November. So far, no one has filed a hole-in-one claim.

–Dean Foust

INDIE POWER

IS LITTLE LIONSGATE SET TO ROAR?

SITTING IN TORONTO'S faded Elgin Theater in 2004, Tom Ortenberg felt the heat. The president of tiny **Lionsgate's** film studio, Ortenberg was among the Hollywood heavies taking in the racially charged film *Crash* at the Toronto film festival—and bid $3.3 million on the spot for its U.S. rights. "No one else seemed to want it," he recalls.

Too bad for them. *Crash* went on to become a bargain-basement hit, generating an estimated $65 million in revenues and $30 million in earnings for Lionsgate. On Mar. 5, Lionsgate may get its Miramax Moment, that magic time when a smaller, artier house gets to strut at the expense of the big studios before the Academy Awards' global TV audience. Nominated for six Oscars, including Best Picture, *Crash* is drawing some last-minute attention as a challenger to gay cowboy flick *Brokeback Mountain*. A *Crash* upset could vault Lionsgate beyond its status as king of the niches into a powerhouse independent studio.

***CRASH* DEAL** U.S. rights cost Lionsgate only $3.3 million

Together with Lionsgate's rich library—which includes *Dirty Dancing, Reservoir Dogs,* and *Terminator 2*—a big Oscar night could also make the studio an acquisition target for media companies beefing up content in a world of downloads and movies-on-demand. So says analyst Robert Routh of **Jefferies & Co.**, who follows the stock and owns shares. He figures everyone from **Comcast** to **Walt Disney**, which recently lost the services of Miramax brothers Weinstein, could u a studio whose lower-budge films cut through the clutter

Lionsgate says it is not considering a sale. But top execs Michael Burns and Jo Feltheimer spent $4 million on the Oscar campaign, sen ing *Crash* DVDs to all 130,0 Screen Actors Guild (SAG) members, even though only about 1,400 are Academy members. That won a surpri best-picture award from SA and pre-Oscar momentum. Who knows? Maybe Lionsgate will grab gold beyond that 8½-lb. statue.

–Ronald Grover

CUT THE CAKE

SEVERAL FOOD COMPANIES are going out of their way to celebrate anniversaries this year. Here's how they are trying to rope customers into the event.

	ANNIVERSARY	PLANS
Twinings	300	Updated tea packaging; new blends such as "Citrus Spice Sunset" and "African Rooibos Red"
Kellogg	100	Kellogg's characters ring tones on new Web site; product launches such as Special K Snack Bites
Planters	100	National tour for the Nut Mobile; a bronzed Mr. Peanut statue on the Atlantic City Boardwalk
White Castle	85	Free meals for the 85th customer of the day throughout May at selected restaurants
Quizno's	25	Will give away 12 franchise restaurants through sweepstakes and other contests

Data: *BusinessWeek*, company re

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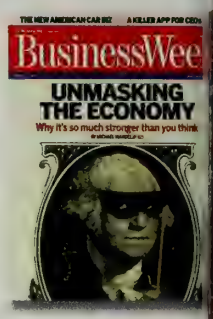
"[Despite] all the 'feel good' analysis . . . we will be adding another trillion dollars of debt . . . for future American generations."

–John Henry
Naples, Fla.



UNMASK THE ECONOMY AND IT'S BETTER—OR WORSE—THAN IT SEEMS

MY ANGST CONCERNING the economic future of our country was momentarily relieved while reading and digesting "Why the economy is a lot stronger than you think" (Cover Story, Feb. 13). Nonetheless, all the "feel good" analysis about intangibles, the value of intellectual capital, physical capital, etc., does not obscure the hard fact that with a $400 billion federal government deficit and a well over $700 billion current account trade deficit, we will be adding another trillion dollars of debt obligations for future American generations to deal with. This external and federal debt, combined with the record personal home equity, mortgage, and credit-card debt, will eventually result in major economic challenges for the country.

So while your article may have momentarily unmasked the economy, I still do not like what I see.

–John Henry
Naples, Fla.

"WHY THE ECONOMY is a long stronger than you think" is yet another hallmark exposé by Michael Mandel. His thoughts on antiquated economic measures also extend to the corporate world. In fa many of these outdated measures e anate from corporate financial reporti that does not reflect today's knowled economy. Any accountant who does understand the adage "relevancy los should read this article.

Companies such as Apple Comput General Electric, and Samsung dri growth and prosperity through investi in innovation, technology, and market d velopment. Financial statements that flect this investment will eliminate the Fe eral Reserve's need to "dig into arca factoids." Let's overhaul the accountin profession so we can unmask the econom

–Randy R. Willia
Syracuse, N

IN YOUR COVER STORY about the sha ow economy you extend a discussi about improper measurement of gr domestic product into an excuse for ov spending by our government. Howe good the cause, such as education, cannot go on living beyond our means

The end result of your discussion is create a balance sheet for the U.S. gove ment. But as we all know a company w a great balance sheet can quickly go un

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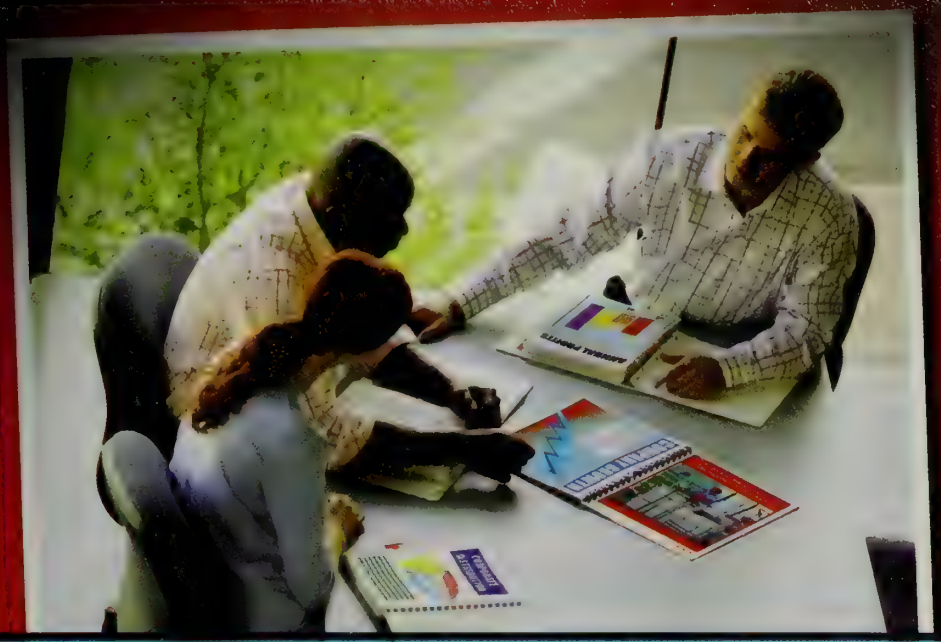

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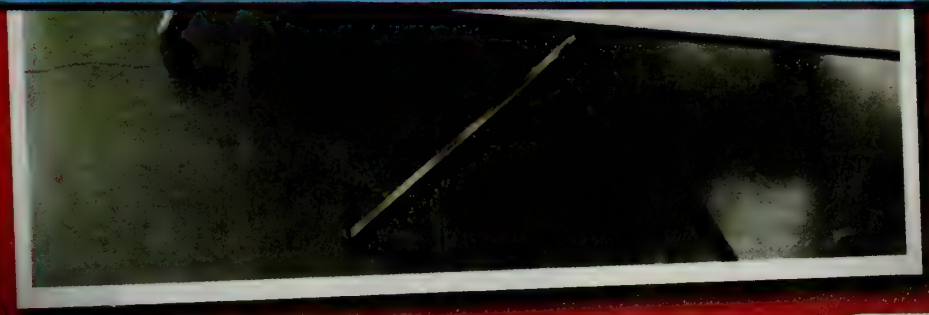
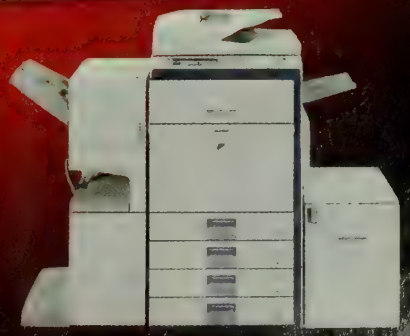
How many can actually help you achieve them?





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if the cash flow statement is a disaster. None of the measures you discuss will change the cash flows. Further stating that personal savings would be positive if expenditures for education were not counted as consumption makes the same mistake.

–Mike Grosner
San Diego

THE PROBLEMS WITH our national economic statistics are more serious than you report. Not only do we fail to count all the relevant positives, as you report, but we count as positive many transactions that, in fact, add little net value or detract from our national wealth. For example, the billions to be spent rebuilding the Gulf Coast will be recorded as dollar-for-dollar contributions to our national economic well-being, when all they do is get us back to where we were, or perhaps slightly ahead. Likewise, huge sums of money spent fighting crime and terrorism, and incarcerating criminals, however necessary, are recorded as net contributions to our national wealth. In fact, these expenditures are net detractors as they divert money from investments such as education, research and development, and infrastructure.

–Neil L. Drobny
Columbus, Ohio

YOUR ANALYSIS was a search for asset omissions and failed to address the magnitude of unrecorded liabilities, such as the obligations for Medicare, Medicaid, and retirement, which are increasing faster than income and will soon make huge deficits very much larger and create a fiscal and economic crisis.

You treated education spending as an investment rather than as a cost of production. After all, if capitalized, it would have to be amortized. The higher level of education spending was treated as a plus; however, the higher spending is inefficient, since the U.S. spends much more than any advanced nation on education, for, at best, no better results. Treating education as a positive adjustment to national savings is clearly inappropriate. Also, for comparative purposes, you would have to treat all countries' education as an investment, which would reveal even larger gaps in national savings.

–Morton Egol
Hastings-on-Hudson, N.Y.

Editor's note: The writer is author of the book, *Dynamic Scoring: Reinvented Accounting for a New Management Paradigm.*

"DOUBLE DIPPING" TO PAY FOR COLLEGE

AS A PARENT in the midst of financing the college expenses of three children, I read "Tuition: It's not like an ice cream cone" (Cover Sidebar, Feb. 13) with great interest. Following your dessert theme, it would seem that the writer is practicing "double dipping." If possible, college education should be paid for using funds saved for that purpose. This process generally takes years to accomplish. These amounts would have been taken into account when the national savings rate is tabulated. To get the credit for these outlays a second time seems to be the very fiction the author rails against.

–Steven Jay Tenenbaum
Newtown, Conn.

Editor's note: Mandel responds on his blog (businessweek.com/the_thread/economicsunbound/archives/2006/02/why_college_sav.html).

WAL-MART DOES NOT DESERVE THE BASHING

RE "NO UNION, PLEASE, we're Wal-Mart" (Book Excerpt, Feb. 13). Did I miss something? Has *BusinessWeek* become a journal of opinion for socialism? How can you run an excerpt from Anthony Bianco's Wal-Mart-bashing book, with attendant nasty caricatures and insulting

CORRECTIONS & CLARIFICATIONS

In "Putting a collar on investment risk" (Personal Business, Feb. 20), the gain and loss calculations for each stock in the table take into account potential dividends, based on a company's recent payout history.

"Must love wing tips" (People, Feb. 20) incorrectly stated that Match.com has 8 million members. That number represents only Match.com profiles in the U.S. The site has 15 million members worldwide.

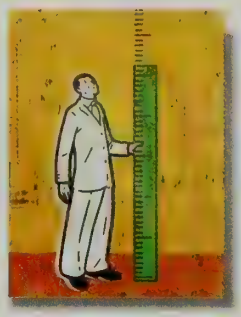
"Checking in? First pass the picket line" (News: Analysis & Commentary, Feb. 20) should have clarified that the Bureau of Labor statistics figure of $8.67 per hour was for union and nonunion hotel housekeepers, of whom approximately 90% are nonunion.

"Donations that suit the taxman" (Personal Business, Feb. 20) erroneously reported that a cancelled check can serve as documentation for a charitable deduction of $250 or more. Such deductions require written acknowledgment from the charity stating the amount of the donation and whether or not the charity provides any goods or services in exchange for it.

dline? The people of Jonquière got ex-
y what they deserve—more unem-
ment, higher prices, and less choice.
heir Wal-Mart was such a terrible
e, people would not have shopped or
ked there, but they did both.
Val-Mart has done only one thing wrong
merica, as well as in Canada: They have
hired effective public-relations people.

–Eric Vollrath
Sturgeon Bay, Wis.

> "Unrecorded liabilities such as . . . Medicare, Medicaid, and retirement . . . will soon make huge deficits very much larger."
>
> *–Morton Egol*
> *Hastings-on-Hudson, N.Y.*



N'T FORGET THE THRIVING U.S. O INDUSTRY—IN OHIO

E GOOD NEWS about America's auto
ustry" (News: Analysis & Commen-
Feb. 13) ignored the fact that the
industry is alive and well in Ohio.
proof is in the numbers: During the
three years, auto makers have in-
ed $3.1 billion in projects in Ohio.
hio is home to thriving foreign auto
ers such as Honda of America Mfg.,
h just celebrated 25 years of business
merica and in Ohio. Others are invest-
n Ohio, too, such as DaimlerChrysler's
million expansion and creation of a
lier park in Toledo and General Mo-
$500 million expansion in Northeast
for building the Chevy Cobalt.

Ohio is first in the number of automotive suppliers in the U.S. and second in the production of vehicles. Ohio is enjoying not only new growth but also a productive history and an outstanding forecast for the future.

–Lt. Governor Bruce Johnson
Director of Development
Ohio Development Dept.
Columbus, Ohio

MOTHERS, FATHERS, CHILDREN, AND THE WORKING WORLD

"WHAT'S HOLDING women back" (The Welch Way, Feb. 13) underrates both women and men because Jack and Suzy Welch assume that men have neither a role nor a responsibility when it comes to raising their children, particularly in a two-working-parent home. No one questions whether men should continue to work or the hours they put in after they have children.

–Chris Hofmann and Ashley Opp
Alexandria, Va.

WAIT JUST ONE SECOND—are we in the year 2006 or 1956? Jack—you ran General Electric, one of the most powerful corporations in the U.S. Are these the views that were underlying GE's job recruitment, placement, and advancement policies while you were there?

BusinessWeek—shame on you for sending subliminal messages to Corporate America that encourage continued discrimination against women by suggesting that they can't be on a fast track if they have children. Shame on you as well for encouraging women to be satisfied with lower expectations for themselves as professionals.

–Marti P. Murray
President & Chief Investment Officer
Murray Capital Management
New York

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High-Flying Dropout

Techdom is renowned for its population of college dropouts who, thanks to innate genius, business acumen, or plain old gumption, actually manage to change the world. Michael Dell, Bill Gates, Steve Jobs—none has a four-year degree. Alex D. Zoghlin goes these luminaries one better: A serial entrepreneur who started Orbitz Inc., Zoghlin never even finished high school.

Zoghlin was student president at New Trier High School in Winnetka, Ill., in 1988, and four months from graduation, when he quit to sell a computer program he had written to manage records for law firms in nearby Chicago. Today he is founder and chief executive of G2 SwitchWorks Corp., a software outfit that is selling flight information at deep discounts to travel agencies. In between he served four years of active duty in the U.S. Navy, where he picked up his GED and specialized in encryption. He also co-developed the first Web server and browser as part of the Mosaic team; learned Mandarin Chinese and studied econometrics at the University of Illinois; raced in the 140.6-mile Ironman World Championship triathlon, finishing in 12 hours and 16 minutes; earned a black belt in Tae Kwon Do; and founded and sold two other companies that, together with his stake in Orbitz, have made him wealthy enough that his wife and three daughters should never have to worry about money. He just turned 36.

Although he works from a cubicle on the 39th floor of Chicago's Sears Tower, Zoghlin seems like your typical Silicon Valley techie, with his ponytail and fleece top and jeans. There's more to it than looks: Zoghlin, who began fiddling with his dad's computer when he was a preschooler, still writes code in his spare time. But he says the last time he did any professional programming was probably 10 years ago when he was running Neoglyphics Media Corp., a Web-site design shop that counted General Motors, Nokia, and Sears among its clients.

What makes Zoghlin successful is that he is more than just a computer whiz. An omnivorous consumer of books and news, he has been able to spot markets where networked computers running just the right program can save customers money and time. Orbitz is case in point. Before Zoghlin was recruited to start the e-ticket vendor in 2000 as its first employee and chief technology officer, travelers shopped online by going to sites relying on mainframe computers. Zoghlin and his airline backers figured a networked arrangement would make it easier to sort among every flight option to rank them by price or time in an easy-to-navigate format. Zoghlin got it right. Cendant Corp. bought Orbitz for $1.25 billion in 2004.

Today he's using the same model to wrest more business from Sabre, Galileo, and Worldspan, which have long dominated the airline reservations system. G2 SwitchWorks, the 60-employee company Zoghlin launched in 2004, has created software that lets travel agents search out and book reservations on the Net. Zoghlin demonstrates, punching into his laptop the kind of query an agent might get: Find the cheapest roundtrip from San Francisco to Chicago, returning two days later during the evening or the following morning. The conventional process would take a skilled agent eight or nine minutes running 16 different searches, he says. His program does it with one click in 30 seconds.

Zoghlin, a serial entrepreneur, helped online travel get off the ground

When Zoghlin left home at 18, he didn't talk to his parents for more than a year. Today they chuckle over his relationship with his own children. Middle daughter Zoe, 3, is particularly headstrong. Says Zoghlin: "My dad is always telling me, 'She is you and this is payback.'" Looking at everything he has accomplished, that wouldn't be so bad, would it? ■

–Michael Arn

BusinessWeek online For more on Zoghlin's unusual career path, go to www.businessweek.com/extra

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Technology&You

BY STEPHEN H. WILDSTROM

HDTV Moves to the Next Level

Judging by the questions I get from readers, the subject of digital and high-definition television is probably the most baffling issue in the world of consumer technology today. It's great that flat-panel displays are getting bigger, cheaper, and more mainstream. But confusion is actually mounting as consumers face yet another HD standard and a DVD format war.

The new kid on the HDTV block is something called 1080p. It combines the best features of the two earlier HD standards: 720p, which can handle rapid action on the screen, and 1080i, which boasts superior resolution. (For those who wish to understand the name: 1080 refers to the number of horizontal lines that make up the picture. The "p" stands for "progressive," the alternative being "i" for "interlaced." Both words are carryovers from picture-tube TVs. In practical terms, p means 60 frames per second, while i is a leisurely 30 frames.)

CLEAR VIEW Sharp's 65-inch Aquos LCD

I've been enjoying a borrowed Sharp 65-inch Aquos LCD display, one of the first 1080p flat-screen models available. The images are stunning, which they should be, given the $20,999 price tag. I was also dazzled by a range of 1080p displays at January's Consumer Electronics Show, including LCDs, projection sets, and plasma screens, ranging in size up to an overwhelming 103-in. Panasonic prototype.

On displays smaller than about 40 in., the difference between 720 lines and 1080 lines is all but invisible and not worth a premium of $500 or so. But on bigger screens, the higher resolution makes a real difference in how lifelike images look, especially when viewed from up close.

THERE IS A BIG DRAWBACK to 1080p, however. At the moment, there is zero commercial programming available in the format, a situation that is not about to change very quickly. Sharp had to send me a hard-drive video recorder loaded with promotional content just to convey the sorts of images the big Aquos can deliver. Without a breakthrough in compression, there won't be 1080p broadcasts. The format gobbles nearly 30 megabits of data per second, more bandwidth than any cable or satellite operator—or broadcaster—can provide.

The glory of 1080p will be in its ability to provide theater-quality images when showing movies on big screens. But that's where a nasty format war gets in the way. A conventional DVD doesn't have room for a whole HD movie, and the studios won't allow HD versions of movies to be released without much stronger antipiracy protection than the DVD's flimsy Content Scrambling System.

The answer is a blue-laser recording system, which can cram far more data onto a disc that's copy-protected with a powerful digital rights management system. Unfortunately, there are two competing solutions that don't work together: Blu-ray, backed by Sony and most other consumer electronics companies, and HD-DVD, supported by Toshiba, NEC, Microsoft, and Intel. You can't play a Blu-ray disc on an HD-DVD player, or vice versa, and neither will play on a conventional DVD machine. (The new players will, however, show standard DVDs.)

> 1080p image quality is dazzling, but don't expect TV shows in the format

I suspect that very few consumers will be willing to plunk down $500 or more for a player that could well turn out to be the new Betamax. So far, the movie studios are hedging their format bets, so the market is likely to stay unsettled for some time.

The first real boost for 1080p displays should come this fall when Sony ships its PlayStation 3. I found that Xbox 360 games, which are limited to 720p, looked spectacular on the Aquos, and PS3's built-in 1080p output should be even better. The new game console will also include a Blu-ray DVD movie player, and by the time it ships, there should be at least a smattering of movie titles available.

If you want an HD display in the popular 30-in. to 42-in. range, 1080p isn't an essential feature. But if you are looking for something bigger, whether flat-panel or projection, the new format could be a good future-proofing investment. ■

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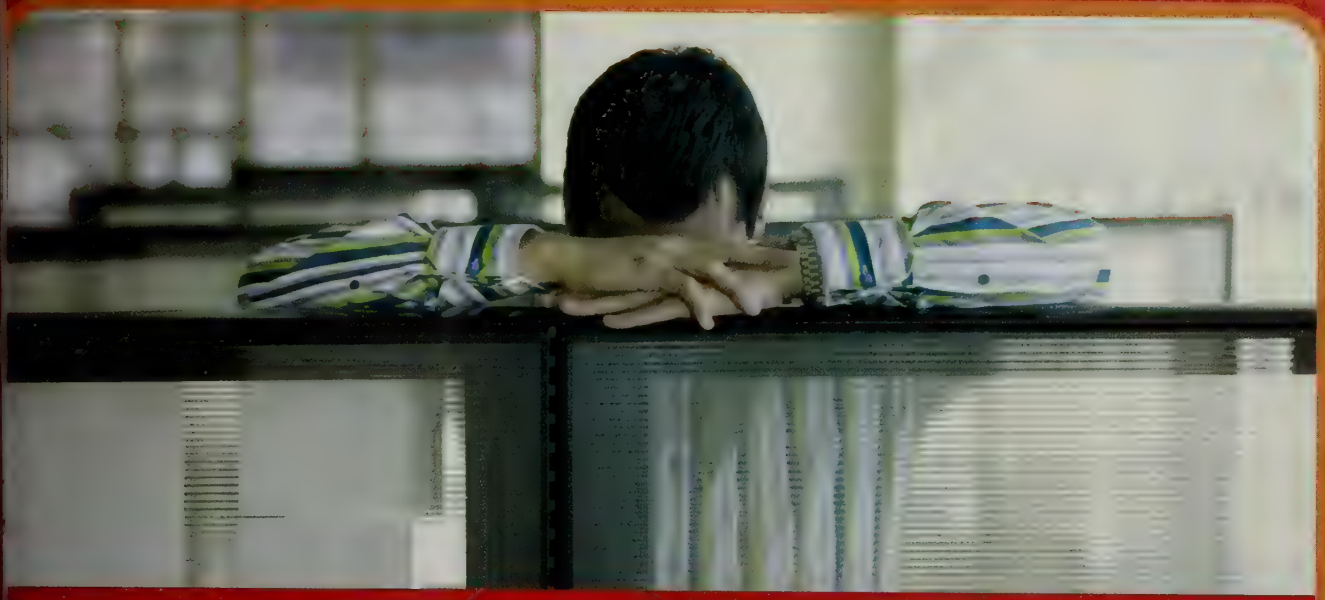
When should you replace your old systems?

(Now seems like a pretty good time.)



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MediaCentric BY DAVID KILEY

Media, Marketing, and Advertising in the 21st Century

Advertisers, Start Your Engines

We may be about to find out just how rambunctious American car culture can get on the Net. On Feb. 27, Edmunds.com, one of the leading sites for car buyers, is formally launching CarSpace.com. It's a bid to apply the social networking model of MySpace.com to folks who tune, race, and obsess over cars. This is no marginal digital media play—drop a dipstick into this plan, and it looks pretty smart.

Social networks differ from older networking roundabouts such as America Online chat rooms and Yahoo!'s member groups by bringing chats, home pages, photos, and file-sharing into one big garage with an easy interface. When you log onto CarSpace, you know the people inside are there to chat and post about chrome rims, the new Bimmer at the auto show, or to help you find a trusted mechanic in Butte, Mont. So you can upload those jpegs of your tricked-out Scion xB, bash controversial BMW chief designer Chris Bangle, and search the profiles for your dream date: "must love NASCAR, cigs, and *CSI*."

Right now this kind of interactivity—on sites such as Edmunds' public forums, Yahoo! Autos, and Cars.com—is highly fragmented and only marginally entertaining. So consolidating all things auto onto one branded site could be a service. It's easy to see why the company, which is keeping mum about specifics until the launch, has high hopes. MySpace gets some 36 million visitors a month and was the eighth-largest site for traffic in January, according to Media Metrix. But the smallish space for users to mix it up about cars doesn't get much traction at a site originally geared to music-file sharing.

EDMUNDS.COM, MEANWHILE, IS UP to 9 million visitors a month, while its year-old offshoot, InsideLine.com, about tuner and performance cars, draws more than 2 million visitors a month. Both sites' capacity for ads is maxed out. Media planners say CarSpace could even pass Edmunds.com's main site for traffic in two years if it gets buzz. "Self-generated content creation and networking are now clearly one of the biggest media growth stories," says Curt Hecht, chief digital officer at GM Planworks, General Motors' media agency.

Here's where it gets interesting for advertisers. They could play a key role in building awareness of CarSpace via their ads in TV and newspapers as well as on their own sites. GM is already sending consumers to Edmunds and Google to check out its new pricing strategy. They'll also buy ads on the site itself. Honda has signed up to be an inaugural advertiser, and GM is close to a deal.

GM is finding it can be better to send folks to a third party such as CarSpace rather than to its own site. GM might want, for instance, to show a new car design or an exclusive, Cadillac-sponsored Aerosmith video. On CarSpace this would have less of a scent of commercialism, though GM's ads and links would be nearby.

Advertisers also like the way social networking can target people by passion rather than age. Look for Web pages by NASCAR drivers, car-loving celebs such as Jay Leno, and auto execs—perhaps Ford CEO Bill Ford. GM's Hecht thinks CarSpace could be an answer to a problem he's been chasing for three years: how to pull together millions of people on thousands of car-enthusiast sites not reached by ad serves into a network he can talk to.

> CarSpace aims to consolidate the audiences of thousands of car-nut sites

Here's a possible piece of the plan, I'm told: CarSpace could invite all those sites, club message boards, and car communities in cyberspace—from the Houston Volkswagen Club to the St. Louis Biodiesel Club—to put their sites inside CarSpace. And, like Google, Edmunds might eventually share ad revenue with those groups for coming into its ad-supported tent.

About 60 million Americans a year buy a new or used car. Among young, first-time buyers on sites such as MySpace, 35% consider the Net their most important shopping tool, says auto researcher R.L. Polk, vs. 8.2% who cite TV and 4.4% who pick magazines. If CarSpace can make its garage a sticky place for car nuts to hang out, the business could be a sweet ride.

BusinessWeek online Jon Fine returns next week. For David Kiley's blog, go to businessweek.com/innovate/BrandNewDay

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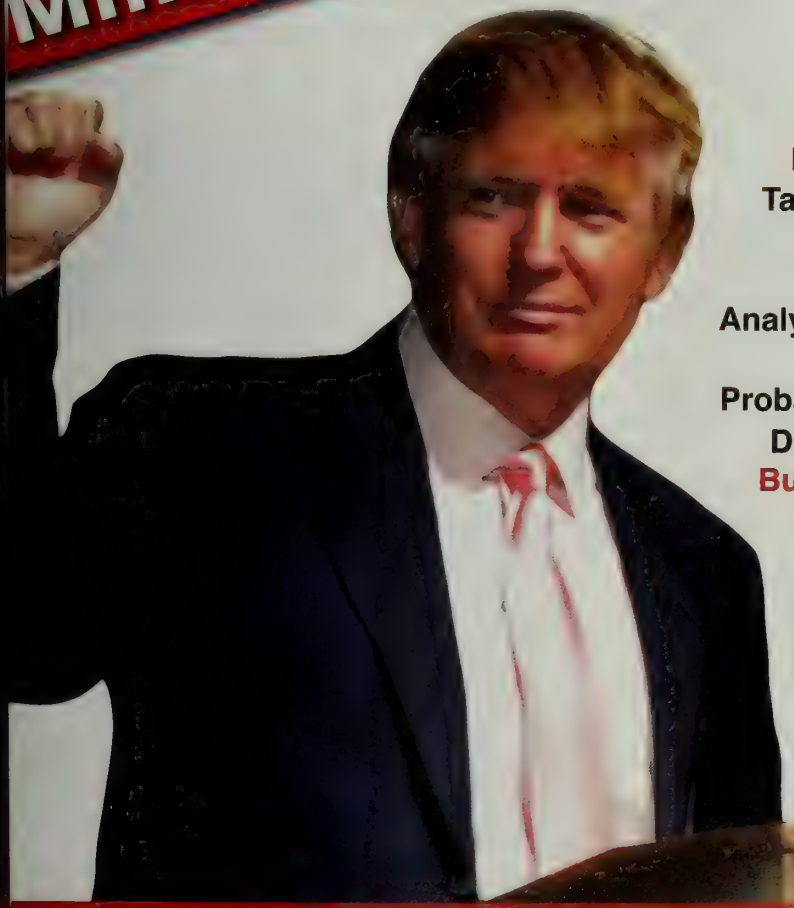

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Y JAMES C. COOPER

It's Not Just Warm Weather Heating Up the Economy

trong job markets, good profits, and easy credit are powering growth

U.S. ECONOMY Given the roller-coaster ride the economic data ave been on in recent months, it's a good time to stand back and take broader view of where the economy is heading. Since last summer, verall economic growth has swung wildly, from a 4.1% annual rate in ne third quarter to 1.1% in the fourth quarter, and analysts now pect a first-quarter pace of 5% or more. The newest mplication is January's record warmth and its impact the data, especially outsize gains in housing starts and tail sales. That makes it even more difficult to discern w much of this quarter's upswing reflects the onomy's true momentum and how much is due to eird weather (chart).

For example, January's 2.3% surge in retail sales from ecember will have a powerful impact on first-quarter nsumer spending, which will, in turn, make an usually large contribution to this quarter's growth in al gross domestic product. Even if consumer spending es not rise any further in February and March, real tlays would increase at an annual rate of about 6%. ven that consumer spending is about two-thirds of P, that's a four-percentage-point contribution to GDP owth by itself.

Clearly, consumers aren't capable of sustaining ending at January's clip, and housing activity is giving ery sign of cooling off, not accelerating. January's usually warm weather boosted other economic data for e month as well, and some of the impacts appear to ve been substantial (box, page 28). Consequently, ny of the numbers on activity in February and March ll most likely look far less robust or perhaps even wnright weak.

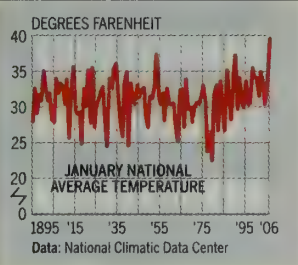
However, looking through the ups and downs, it's portant to keep in mind that even before January, mand by consumers, businesses, and foreigners was king strong heading into the first quarter. The bottom e: Weather is a factor in the first quarter's strength, but not the only one.

ART WITH CONSUMER SPENDING: It's strongly pported by improving job markets, low interest rates mpared with historical levels, and previous gains in alth that still buoy spending even as traditional easures of household savings look ominously low.

Looking past January, new claims for unemployment urance through mid-February remain very low, and level argues for a strong gain in February payrolls to reported on Mar. 10. New claims during the four eks through Feb. 18 averaged below 300,000 per week. In the past, claims that low have been consistent with monthly payroll increases of more than 250,000 jobs.

Job markets have already tightened to the point where wages are starting to increase faster, and consumer prices for energy, while up in January, are still down 5.6% from last September, restoring some buying power. Indeed, weekly surveys of retail activity through the first two weeks of February show that spending is holding up well.

THE ECONOMY? CHECK THE WEATHER FORECAST



Data: National Climatic Data Center

Corporate spending is also solid, as seen in the upward trends through December in orders and shipments for capital goods and in the strong gains in production of business equipment through January. Hiring goes hand in hand with expansion plans, and that pattern will most likely continue in 2006, powered by solid balance sheets, easy credit conditions at banks and in the financial markets, and strong profits.

LAST QUARTER WAS ANOTHER strong showing for corporate earnings. Looking at profits of the 85% of companies in the Standard & Poor's 500-stock index that have reported through Feb. 17, combined with the current earnings expectations of the remaining 15%, analysts at Thomson Financial say fourth-quarter profits are up 14.4% from a year ago. That's the 10th consecutive quarter of double-digit earnings growth, a feat that has occurred only two other times since 1950. Even excluding the windfall gains in the energy sector, earnings were still up 8.8% in a quarter when revenues were depressed by the aftereffects of the hurricanes.

Earnings are sure to slow this year, as they typically do while a business upswing ages. But earnings growth in the high single digits should be easy to achieve. With demand strong, investors will look for top-line revenue growth to drive the bottom line. The tax break on earnings repatriated from operations overseas brought in

a gusher of cash in the second half of last year. Plus, businesses have a little more pricing power, so any squeeze on margins should not be severe.

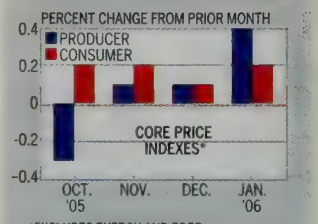
An indication of that pricing power showed up in the January report on producer prices. Overall prices of finished goods rose 0.3% from December, but core prices, which exclude energy and food, were up 0.4%, the largest advance in a year. That could be an early sign that strong demand is allowing businesses to pass along higher energy costs to customers, but so far there is little evidence of that at the retail level. Consumer prices rose 0.7% in January, lifted by energy costs, but core prices were up a tame 0.2% (chart).

FOR NOW, HOUSING is the economy's only sector showing clear signs of cooling. Fourth-quarter sales of both new and existing homes fell below their third-quarter levels. However, the sharpest decline has been sales of existing homes, especially single-family houses, which dropped 4.6% from the third quarter, the largest quarterly decline in 11 years. That weakness is continuing in the first quarter, as indicated by the downturn in mortgage applications to buy a home. So far this year, applications are running 5.9% below their fourth-quarter average, which was 5.4% below the third quarter.

However, it is sales and starts of new homes that are crucial to building activity, and that is what has a direct impact on economic growth. Demand, while down a bit from last year's peak, remains high. But judging by the recent sag in builders' optimism and the rise in mortgage rates, both sales and starts of new homes will most likely head lower in coming months.

Historically, those two indicators closely track sales and starts of new single-family homes. Right now, fixed 30-year mortgage rates are up to 6.28% in mid-February from a low of 5.53% last June. Also, the National Association of Home Builders' housing market index, a composite of builders' assessments of current and future sales conditions, fell to 57 from a peak of 72 last June. Based on past patterns, those levels of rates and builder sentiment have corresponded with sales at an annual rate of about 1 million units and starts at a rate of about 1.4 million. Last year, sales and starts averaged 1.28 million and 1.72 million, respectively.

WILL CONSUMER PRICES REMAIN TAME?



*EXCLUDES ENERGY AND FOOD
Data: Bureau of Labor Statistics

For the rest of the year, housing is sure to play a key role in how much the economy slows from what may well be an exaggerated first-quarter performance. But barring a sudden retrenchment by businesses that would sharply curtail capital spending and hiring, or an unexpected surge in interest rates that would hammer housing, the solid supports under consumer and business demand will help to keep the economy on a solid growth path. ■

BEHIND THE NUMBERS

What Got the Bounce Going

FROM RETAIL SALES to housing starts, the January economic data far exceeded expectations. Economists logically assume that the month's record warm temperatures, which averaged 39.6F, generated a lot of activity that wouldn't normally have occurred. However, the crucial question is: Just how much of an effect did the weather actually have?

UBS economist James O'Sullivan took a stab at quantifying the impacts. He looked at the historical relationship between data from several economic reports and deviations from the average December and January temperatures. December temperatures were used to capture any weather-related distortions that could carry over into January.

A WARM JANUARY MADE FOR HOT RESULTS

	ACTUAL	WEATHER-ADJUSTED
PAYROLL JOBS*	193	124
HOUSING STARTS*	2,276	2,076
RETAIL SALES	2.3%	0.9%
FACTORY PRODUCTION	0.7%	0.0%

Data: UBS *THOUSANDS

Based on these past relationships, the above-average January temperatures provided a 1.4-percentage-point boost to retail sales. Housing starts got a weather-related increase of approximately 200,000 units at an annualized rate, while the balmy temperatures may have accounted for all of the 0.7% rise in manufacturing output. Moreover, the UBS results show that the job growth number was about 69,000 higher than might have been expected had January temperatures been just average (table). The calculations are not meant to provide exact readings after accounting for weather distortions, cautions O'Sullivan, but it's clear the effects in some cases may have been large.

The results show how the government's seasonal adjustment process, which tries to account for typical seasonal variation, can go awry when patterns are atypical. For example, the UBS report notes that the Labor Dept.'s seasonal adjustment expected a decline of 316,000 jobs. In reality, only 270,000 workers were let go, due to the warm weather. As a result, the seasonally adjusted gain was estimated at 46,000, far above the recent trend.

That process played out across much of the January data. One implication: Mild temperatures tend to bring forward a lot of activity that would have occurred later. As the weather reverts to the norm, February and March data may end up looking weaker than they would otherwise. ■

–By James Mehring in New York

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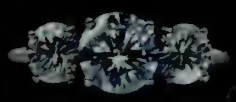

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Storming Over Ports The **Bush Administration** might have seen this one coming. A deal for state-owned **Dubai Ports World** to take over management of six U.S. ports—from **Newark** (above) to **New Orleans**—made Capitol Hill crazy. Lawmakers railed that security could be shot when Dubai Ports, controlled by the **United Arab Emirates,** takes over key entry points for lightly secured container cargo.

By Feb. 21 top Republicans in the House and Senate were calling on **President George W. Bush** to rescind U.S. approval. The Treasury-chaired **Committee on Foreign Investment in the U.S.** O.K.'d the takeover as part of Dubai Ports' $6.8 billion buyout of London-based **Peninsular & Oriental Steam Navigation,** and a defiant Bush says he'll veto any move by Congress to undo the deal. But that wouldn't keep Dubai Ports from heeding Capitol Hill's bipartisan fury and bowing out.

See "The real shipping news," page 40

Oil Patch Unrest Nigerian militants, angry that so little of the **Niger Delta's** oil riches filters down to locals, stepped up their guerrilla-style campaign. On Feb. 18 they attacked a barge belonging to a **Royal Dutch/Shell** contractor, took nine expatriates hostage, and bombed a pipeline. **Shell Petroleum Development,** a joint venture with the Nigerian government, has shut down 455,000 barrels per day of production, nearly half of its output in Nigeria and a fifth of the country's total. Prices spurted from the mid-$50s per barrel to the low $60s, but such a large outage might have caused them to spike higher were traders not in a bearish mood.

Satellite Radio Red Ink Sure, you've got to spend mor ey to make money. But are sat-radio companies **XM Satellit** and **Sirius Satellite** going overboard? It looks that way t **Pierce Roberts Jr.,** onetime **Bear Stearns** investment banke who quit as a director of XM on Feb. 16 just before the com pany revealed nastier-than-expected 2005 losses of $66 million on revenues of $558 million. The next day, Siriu too, reported surprisingly steep losses: $863 million on rev enues of $242 million. Pricey programming—such as $50 million for Howard Stern at Sirius—and lofty marketin costs have sent expenses into outer space. XM shares fe 13% in the three days after the news, and Sirius lost 11%, a though both have come back a bit.

Stop That, Microsoft! Where do you want to go today Not to Europe if you're Microsoft. Its legal woes there mu tiplied on Feb. 22 as a group whose members include **IBM Oracle, Red Hat,** and **Sun Microsystems** formally complaine to the **European Commission** about Microsoft practices that says throttle competition, such as bundling critical pro grams with its operating systems. Already, the EC has fine Microsoft $613 million in a case that's under appeal. Snifl Microsoft in a statement about the new beef: "When face with innovation, they choose litigation."

A Bolt from E.on More evidence that supercharged en ergy prices aren't bad for everyone: German utility gian E.on made a $34.6 billion all-cash offer on Feb. 21 fo Spain's **Endesa.** Besides giving E.on access to market growing faster than Germany's, the move short-circui shareholders who might have clamored for the company t pay out its cash hoard, fattened by 2005 profits of $8.8 bi lion—up 71%—on sales of $67 billion. Other Euro utilitie such as **Gas Natural** of Spain, which previously bid abo 30% less for Endesa, and Germany's **RWE** are expected t hunt for prey as well, trying to add muscle as the EU pre sures member countries to set energy markets free.

See "E.on bids big for Endesa, www.businessweek.com/go/tb

Lerach and Weiss in the Clear How many lives do Bill Lerach have? The class action lawyer extraordinai and bane of Wall Street survived congressional efforts kill his booming shareholder lawsuit business in 199 Now he has dodged another bullet. On Feb. 17, Justi Dept. investigators told Lerach and his ex-partner, Melv Weiss, that they won't be indicted in a five-year inqui into whether their firms paid kickbacks to plaintiffs. Th duo parted ways in 2004, but their respective firms conti ue to file the lion's share of shareholder complaints. Pros cutors may still go after lawyers at the firm they founde now called Millberg Weiss Bershad & Schulman.

A Big Pipeline Deal If you live in the Midwest, there hope your heating bills could ease, oh, maybe a deca from now. On Feb. 21, **ExxonMobil, BP,** and **ConocoPhilli** said they had reached an agreement with Alaska to build gigantic pipeline that would snake natural gas from Pru

e Bay through Canada to Chicago. **Alaska Governor Frank rkowski** proposed a new energy tax structure that would ve the way for construction. The estimated cost and netable for the 3,600-mile tube: $25 billion and 10 years.

hn Calls It Quits It would take powerful spin juju to ke **Carl Icahn's** exit from the **Time Warner** battle look like a tory. The stock has hardly left the $17 neighborhood since hn's group started buying its 3% stake in August. And the oits he won from **CEO Richard Parsons** won't soon ignite the ce either, say analysts. A $20 billion stock buyback will ly hike debt to an ouchy $35 billion. The deal, which calls $1 billion in cost cuts, will probably nudge earnings up by neager 3% per share, figures JPMorgan Chase analyst ncer Wang, not enough for anyone on Wall Street to upde the stock. That's far from nirvana for Icahn.

See "Still an improbable Robin Hood," page 36

mmers Steps Down He often seemed like a bull in a loma shop, but the real reasons **Larry Summers** stepped vn as **Harvard President** on Feb. 21 have more to do with how gh it is to make changes at a modern research university.

See "Outside Shot," page 114

nzo Growth in Japan The Japanese population may shrinking—down 4,000 in 2005—but the nation's nomy is rising again. On Feb. 17, Tokyo said GDP exded at a sizzling 5.5% annual pace in the October-Deber quarter, far hotter than the 1.1% U.S. rate. Econots now figure that in 2006, Japan could outpace the . in GDP growth for the first time in 15 years.

Loser of the Week

st over a year ago, **RadioShack's** board was full of pride orchestrating a change of the guard in textbook shion. In naming **David Edmondson,** a 10-year company teran and proven manager, as its new CEO, the outgoig boss crowed that the transition would be seamless. he board and I have made succession planning a prity," said **Leonard Roberts.** "Well, it id off!"

DAVID EDMONDSON

Some payoff. Nine months after mer preacher Edmondson took er, he resigned in disgrace on Feb. after admitting his résumé falsely imed a bachelor's degree in psyology from **Pacific Coast Baptist Colle.** He leaves behind a troubled nsumer retailer with sinking profit, a risky turnaround plan that ls for closing 700 stores, and zero eet cred after a 35% plunge in its stock in less than a r. Another legacy: More succession committees may k up the meaning of "due diligence."

See "RadioShack's lesson: Trust, but verify," www.businessweek.com/go/tbw

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ENERGY

HERE COMES LUNAR POWER

It's not on Bush's alternative-energy agenda yet, but moon-driven tides, ocean currents, and waves generate more oomph than wind and are more consistent than solar. BY ADAM ASTON

A DRAMA IS UNFOLDING in New York City's East River. This summer the Popsicles at a Gristedes supermarket on Roosevelt Island, midstream between Manhattan and Queens, will be kept icy by power generated just a stone's throw from the riverbank. Anchored 30 feet down, six underwater turbines will turn day and night, driven by the tidal flows in the channel. At a fish-friendly 35 rpm, the propellers will crank out up to 200 kilowatts of clean power, or roughly half the peak needs of the supermarket.

Projects like this one are still small fry. But hydropower, the granddaddy of green energy, is making a comeback. Think Hoover Dam, but less visible and a whole lot easier on the environment. This born-again breed of clean energy isn't yet on the agenda for George W. Bush, who is out barnstorming the nation on behalf of renewable power. The President is pointing to the earth for plant-based ethanol, to the sky for wind power, and to the sun for photovoltaics. But he should also be pointing to the moon, say fans of the new hydropower, and to the seas that lie below it. Tugged by lunar gravity and stirred by wind and currents, the oceans' tides and waves offer vast reserves of untapped power, promising more oomph than wind and greater dependability than solar power.

The appeal of next-generation hydropower is hard to miss. "It's local, reliable, renewable, and clean. Plus, it's out of sight," says Trey Taylor, president of Verdant Power LLC, the Arlington (Va.) startup developing the East River site. Adds Roger Bedard, ocean energy leader at the Electric Power Research Institute (EPRI), the industry's research-and-development arm: "Offshore wave a tidal power are where wind was 20 yea ago, but they'll come of age faster." 2010, Bedard predicts, the U.S. will about 120 megawatts of offshore wa energy—enough to power a small city up from virtually zero today.

GROWING DEMAND

THE PLANETS ARE certainly in alignm for hydro. Prices for natural gas and c are high, making renewables more co competitive. And in an effort to halt mate change and cut energy imports, states have mandated that a share of th power come from green sources. Dema for alternatives is soaring: U.S. wind pacity surged by nearly 2,500 megawa last year, up 35%, and solar is sizzling.

Wind and solar won't be able to sati all the green-power mandates. So m than two dozen companies worldwide

O IN THIS SECTION:

7 A new battle over boardroom clout

38 The car dealer conundrum at GM

40 Behind the Dubai deal

42 Secrets of Google's success

"You can't know if the wind will be up in an hour, but you can predict the tide 1,000 years from now."

–George Hagerman, senior research associate at Virginia Tech

ING THIS SUMMER Artist's rendering lal turbines set to be built in York City's East River

developing systems to unlock the power of waves and currents. The first to sell devices to a commercial project is Edinburgh's Ocean Power Delivery Ltd. Its Pelamis system is a snake-like steel tube that floats, semi-submerged, in the ocean (table).

In its Scottish factory, OPD is putting the finishing touches on three of these 400-foot-long machines. This summer they'll be towed to a site three miles off Portugal's northwest coast and hooked into the power grid. Lying low in the water, the snakes are invisible from a distance, unlike offshore wind farms that are causing "not in my backyard" complaints across the Atlantic, on Cape Cod. Initially the project will supply 2,500 kilowatts of juice, enough to run 1,500 Portuguese homes. OPD hopes to have 30 units at the site by 2008, pumping out enough current to power a town of 15,000 homes.

With its vast stretches of shoreline, the U.S. has some 2,300 terawatt-hours of potential near-shore wave power, estimates EPRI. That's more than eight times the yearly output of the nation's existing fleet of hydroelectric dams—"a very significant resource," says Bedard. What's more, since water is heavier than air, marine systems pack a bigger punch than wind power. Because they work not by impounding rivers behind costly bulwarks but by tapping water's energy as it ebbs, flows, rises, or falls, up-front costs are lower than for dams. Maintenance to keep away barnacles and similar "biofouling" generally runs higher than for wind. Still, on balance, wave energy will evolve to be cheaper than wind was at similar levels of development, Bedard believes.

The power is more predictable, too. Unlike dam-based hydroelectric generators, which depend on rain or snowpack to keep current flowing and which shut down during droughts, newer "hydrokinetic" systems exploit less capricious natural forces. "Lunar power" is the term offered by experts such as George Hagerman, a senior research associate at Virginia Tech and co-author of a recent EPRI marine-energy study. "You can't know if the wind will be up in an hour," he says, "but you can predict the tide 1,000 yea from now."

Hydropower already propelled one re olution in the U.S. Starting in the Gre Depression, the government erect thousands of dams, spreading che power across many states. Today they su ply 7% of U.S. demand, some three tim the combined share of wind, solar, a other renewables. Yet even as existi dams are being upgraded, environment concerns thwart new building.

EUROPEAN EMBRACE

BEFORE THE U.S. FULLY taps tidal pow it will have to play catch-up. Marine-ene gy R&D was born in the energy progra of the Carter and Reagan eras, but the experiments lost their funding in t 1980s. "We were the leaders wh I started out. Now Britain is entreating to set up there," says Verdant's technolo director, Dean Corren. He dreamed up t East River project in the mid-1980s wh investigating alternative power at N York University. But then "power g cheaper, and research stopped," he says

In Europe, there is a long history subsidies for renewable energy. For e ample, the EU-backed European Mari Energy Center Ltd. in Orkney, Scotlan is a one-stop shop for lunar startu Entrepreneurs can get a test rig in t water and get hooked up to the g quickly, says EMEC managing direct Neil Kermode.

Ocean Power Technologies Inc. in Pe nington, N.J., opted for a London sto listing because of stronger interest fr European backers, says CEO George Taylor. Both the U.S. Navy and Iberdro a utility in Spain, have signed contracts test OPT's PowerBuoy, which genera energy by bobbing up and down.

In the U.S., last year's energy bill rais hopes in the hydropower community. unifying the licensing of offshore wi and marine-energy projects under the j risdiction of the Interior Dept.'s Miner Management Service, "it sets the stage f faster approvals," says Carolyn Elefa co-founder of the Ocean Renewable En gy Coalition. But the bill failed to rec nize ocean energy as eligible for the so of production tax credits that jump-sta ed wind power investment in the '90s.

At the East River, Verdant is confide its compact submarine turbines are rea for the long haul. Once an 18-month t is completed, Verdant hopes to get O.K. to install up to 300 turbines. T would generate enough power to sup some 8,000 New York homes. "It's flight at Kitty Hawk," says Taylor. ■

Awash In Power

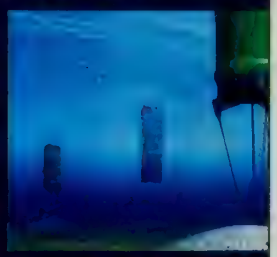
Companies are working on dozens of ways to unlock the energy of waves and currents. Here are a few:

THE LIMPET

Acquired by Voith Siemens Hydro last year, **Wavegen** developed the Limpet (left), one of the first devices to transform onshore waves into power. Water surges into a chamber that compresses air to drive a generator.

THE PELAMIS

Moored a few miles offshore, four of these floating plants (below) from **Ocean Power Delivery** will begin to power a town in northern Portugal this summer. The Pelamis converts wave motion into pneumatic pressure to drive a set of turbines.



THE WAVESWING

Anchored to the ocean floor, the WaveSwing from **AWS** (above) is fully submerged. Tidal pressure from above forces an air-filled tube down over a vertical generator.

© Worms games created in North England by Team17 software Ltd.

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STILL AN IMPROBABLE ROBIN HOOD

Icahn is out to recast himself as the investor's champion. That image has its critics

BY RONALD GROVER

BACK IN THE 1980S, CARL Icahn was considered a merciless corporate raider. In recent years he has tried to change his image. Glomming on to the rise of shareholder activism after the corporate scandals, Icahn has styled himself a champion of shareholder democracy. In his battle for control of Time Warner Inc. he sounded like Robin Hood, complete with a merry band of board candidates boasting long histories of activism. Even in defeat he acted like a man of the people.

But the image of Icahn as the shareholder's best friend doesn't always jibe with reality. Two groups are suing him, alleging rampant self-dealing at companies he controls, while a leading shareholder rights group last year recommended that he not be reelected to the board of a company he controls.

The trouble doesn't stem from Icahn's hedge fund, the $2.5 billion Icahn Partners LP, which was formed in late 2004 to hunt big corporate prey. Despite the Time Warner setback, ICAP investors have had little to complain about. The fund uses the same basic playbook that has made Icahn a billionaire over the years: It zeroes in on a company and tries to acquire it or gain control so the fund can sell off assets or the company itself. ICAP is believed to have posted a gain of over 30% in its first year. "Look at our returns," says Icahn. "That's what shareholders want."

But some of Icahn's dealings have raised eyebrows among shareholder rights advocates. In September he was hit with a lawsuit by minority holders of the Sands Casino Hotel in Atlantic City, N.J., who allege that Icahn combined the casino's assets with his holding company, American Real Estate Partners LP, without giving them the chance to sell their shares. "I see this guy on television all the time talking about shareholder rights, and then we get this kind of stuff," says Michael Stortini, a homebuilder who runs an investment fund that owned 16% of GB Holdings Inc., which owns the Sands. Stortini is among a group of investors who have also asked a Delaware bankruptcy court to overturn the deal. An Icahn attorney says the suit has no merit.

Icahn has also rankled shareholders of XO Communications Inc., the Reston (Va.) telecommunications company I brought out of bankruptcy in 2003. Sinc then, XO has posted losses totalin $620.6 million. In November, Icahn an XO struck a deal for Icahn to pay $70 million for XO's national wireline bus ness. The money would go to repay lon term debt and preferred shares, most which are held by Icahn, leaving the con pany with $300 million and Icahn with prized asset. "It seems like the definitic of hypocrisy," says William Holloway of R2 Investments, an 8% shareholde that filed suit to unwind the deal, citir Icahn's control over XO's board and a "unfairly low price." Says Hollowa "Icahn has been publicly arguing f Time Warner shareholders to have voice. Why won't he let XO minori shareholders have a meaningful vote?"

TOO CLOSE TO THE BOARD?

XO ATTORNEY Bruce Kraus counters th the company examined more than 8 bids and that Icahn, whose bid was t highest, agreed to step aside if a high one emerges.

Icahn's grip over XO came und scrutiny last April by Rockville (Md.) a visory firm Institutional Shareholder Se vices Inc., which counseled large i vestors to withhold votes for five of t board's eight candidates, including Icah for chairman, because it believed XC board wasn't ind pendent enough. doesn't matter if y own a majority of t company," says I Vice-President Patri McGurn. "You ca trample the rights minority shareho ers." XO has sin elected two indepen ent directors.

Icahn is unapol getic. "My critics sa am short-term-orie ed," he says. "M point is that a lot times assets can better utilized and e hance society wh you put them in better han than the current manag ment." A lot of times th can. But having Carl Ica take a big stake in a co pany doesn't alwa make for happy sha holders. ■

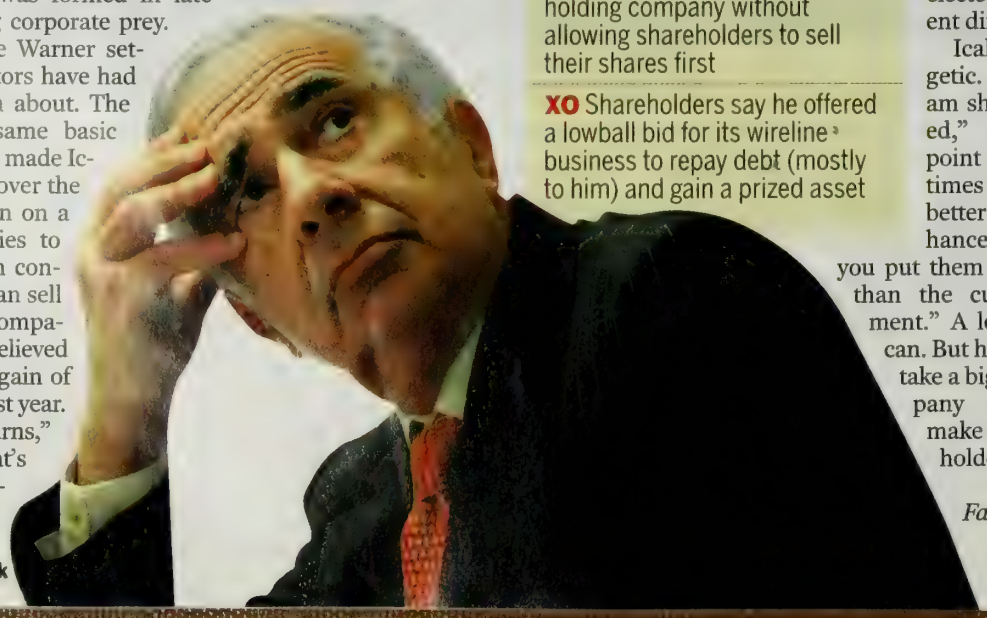
–With Rob Farzad in New Yo

Beyond Time Warner

Some minority shareholders say Carl Icahn is self-dealing:

SANDS CASINO HOTEL He combined its assets with his holding company without allowing shareholders to sell their shares first

XO Shareholders say he offered a lowball bid for its wireline business to repay debt (mostly to him) and gain a prized asset



OVERNANCE

SHOULD DIRECTORS BE NERVOUS?

ctivists are pushing majority-vote rules as weapon against unresponsive boards

AMY BORRUS

CURBS ON CEO PAY. Checks on board cronyism. Reining in conflicts of interest. Labor and public pension fund activists have waged hundreds of proxy battles in recent rs but rarely with much effect on tar- companies. Now shareholder activists attacking the process by which direc- themselves are elected. And there are s some boards are listening.

hareholder resolutions at some 140 panies, from Hewlett-Packard Inc. to ls Fargo & Co., would require direc- to garner a majority of votes cast to the board. Currently, nominees need in only a plurality of votes, although t win a majority anyway because di- or elections are usually uncontested. disgruntled shareholders rarely vote figuring it's a futile gesture. So ac- ts hope the dynamic will change if a rity no-vote could actually unseat a ctor. A majority-vote standard "would put teeth in board elections," says Shirley Westcott, managing director of policy at Proxy Governance Inc., which advises institutional investors.

Democratizing director elections wouldn't necessarily revolutionize board politics. Shareholder activists aren't looking to sweep out whole boards en masse, says Carol Bowie, director of research at the Investor Responsibility Research Center Inc. They would be more likely to use majority voting selectively, to show a disappointing director the door or as leverage with an unresponsive board. "The most important benefit won't be the few instances in which it's exercised. It's the awareness that shareholders have this power that would make boards more attentive," says Harvard Law School professor Lucian A. Bebchuk.

Target: Directors

Number of proxy resolutions requiring board directors to receive a majority of votes

2004	2005	2006
12	62	140+

Data: Institutional Shareholder Services Inc.

"EXCESSIVE CEO PAY"

GIVEN WIDESPREAD frustration with lavish CEO pay, directors who sit on compensation committees would be especially vulnerable. Proposals by the Securities & Exchange Commission to expand disclosure of executive pay will help, say investor advocates, but they won't get to the root of the issue. "Excessive CEO pay is a symptom of a board that lacks accountability to shareholders," says Richard C. Ferlauto, investment policy director at the American Federation of State, County & Municipal Employees (AFSCME), which has filed several majority-vote measures.

One of its prime targets is Denver-based Qwest Communications International Inc., whose stock price is down 83% from five years ago. Qwest, without admitting or denying wrongdoing, paid a $250 million fine in 2004 to settle securities fraud charges by the SEC but is still mired in shareholder suits. AFSCME thinks the board has been too generous to the new CEO, Richard C. Notebaert, who last year got a grant of one million shares and an increase in his bonus from 150% to 200% of base salary. A Qwest spokesman says the company hasn't yet taken a position on AFSCME's resolution.

Business groups are wary of changing the current system. The U.S. Chamber of Commerce opposes majority voting, which it perceives as the agenda of "activists who want to have some degree of leverage over companies for political or other goals," says Chamber Vice-President David Chavern. The Business Roundtable, an association of big-company CEOs, isn't fighting the change, although it worries about board elections turning into political campaigns or destabilizing companies, says Thomas J. Lehner, the Roundtable's public policy director.

Still, more than 30, including Dell Inc. and Supervalu Inc., have adopted majority voting this year after heat from shareholder groups. The campaign also has support from groups such as Institutional Shareholder Services Inc. Its proxy recommendations typically swing about 20% of investor votes, says ISS Executive Vice-President Patrick McGurn. The result: Directors could wind up in the spotlight more than many may like. ■

COMMENTARY

BY DAVID WELCH

The Other Club Battering GM

It has twice the dealerships it needs, but their clout makes cutting them costly

EVERYONE KNOWS union resistance is a major drag on General Motors Corp. as it tries to turn itself around. But when it comes to maintaining the status quo, car dealers have at least as much power as the United Auto Workers. ¶ True, GM franchisees last month agreed to absorb lower margins when the carmaker cut prices. That's a real concession since many of these guys are hurting. But the fact remains that GM has too many dealers, who often compete with each other and put even more pressure on prices. Though it sells nearly twice as many cars in the U.S. as Toyota Motor Corp., GM has about five times as many dealers: 7,500 vs. 1,422. Do the math. GM theoretically could stand to lose half of its franchises.

Easier said than done, thanks to tough state laws that require GM to have a pretty good reason—malfeasance on the part of a dealer, say—to yank a franchise. One way around that is for GM to declare bankruptcy, which the company says it won't do. "Everyone talks about the unions and the financial difficulties facing GM and Ford," says J.D. Power & Associates President Stephen C. Goodall. "But both have too large a dealer body, and it's almost impossible to reduce it."

Dealers know they have power. When GM euthanized Oldsmobile in 2000, franchisees demanded big payouts, while some sued. GM wound up paying about $1 billion to bury the brand. Some Olds dealers still haven't settled.

Since axing another division is unpalatable, GM is trying a different tack: putting Pontiac, Buick, and GMC trucks under one dealer roof in every market. It's like merging three sub-brands into one. At the same time, the company is cutting redundant models—look-alikes marketed under more than one nameplate—and offering only unique cars and trucks for each division. Pontiac, for one, is slimming down from eight models to five.

For dealers who sell one brand, fewer models can mean lower volumes and profits. That's why GM hopes to convince the stand-alone crew to sell their stores to other dealers. By the end of 2007, sales and marketing chief Mark LaNeve says triple-play stores will drive 75% of sales from Buick, Pontiac, and GMC.

DEALER MATH

	GM	TOYOTA
U.S. Sales (2005)	4.4 million	2.3 million
÷ Number of Dealers	7,500	1,422
= Sales per Dealer	587	1,617

TRIPLE PLAY GM wants fewer one-brand stores

Keeping to that schedule won't be easy. To understand wh visit Wilmington, Del., where John Gambacorta sells Buic and GMCs. Gambacorta is understandably reluctant to exit business his family has been in since the '30s. GM hasn't ma him an offer, but based on buyouts at other Buick franchis Gambacorta stands to get a lump sum that adds up to just a fe years of his pre-tax haul. No wonder he'd rather buy out t Pontiac dealer across town—if only he could raise the mone

But if the lean times go on, Gambacorta may have to sell o While many franchisees make enough to buy vacation hom and join country clubs, dealer margins last year slipped to 1.6 a five-year low. Frank Ursomarso, another Wilmington deal says he can adequately advertise his Pontiacs only by siphoni money from his Honda, BMW, Volvo, and Jaguar dealers. A some dealers are losing top salespeople. "They put a dealer every corner, and it's survival of the fittest," says Gambacor "In the heyday, everyone survive But all that's changed."

For GM, the question is h much time and treasure it will ta to get the 350 stand-alone dealers go away. GM's franchisees still ha clout thanks to those state la which tend to favor the dealer. La year, AutoNation Inc. sold a Dall Buick franchise to a Pontiac-GM dealer, but only after GM cut the retail chain a check for 6 grand. If GM was forced to do that every time it wanted close a dealer, the bill would quickly amount to $200 milli or more.

Franchise power manifests itself another way. When Pont dealers demanded a compact coupe to fill out their shrink lineup, GM agreed to give them something called the G5. Tro ble is, it's a sexed-up Chevrolet Cobalt—precisely the kind brand smudging GM is trying to avoid. ■

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HOMELAND SECURITY

THE REAL SHIPPING NEWS

Behind the furor over the Dubai deal is a well-respected company with global reach

BY STANLEY REED

THERE MAY BE A FUROR in Washington, but the global shipping industry does not share Capitol Hill's security concerns over Dubai Ports World, the United Arab Emirates company that could soon be operating shipping terminals at several major U.S. ports. The terminals have been managed by Britain's Peninsular & Oriental Steam Navigation Co., which Dubai Ports just agreed to acquire for $6.8 billion.

In the shipping world, Dubai Ports enjoys a solid reputation as one of the Middle East's most successful companies. With its emphasis on services, Dubai has become a thriving trade center not only for the Persian Gulf but for Asia. "They ran a very efficient and successful port for years before they expanded into the international arena," says Neil Davidson, research director of London's Drewry Shipping Consultants Ltd.

Dubai, which has only modest oil reserves, has staked its future on an incredibly ambitious drive to be the region's leading commercial hub, a kind of Hong Kong on the shores of the aquamarine Gulf. As part of this strategy, the al-Maktoum royal family first developed the monster port called Jebel Ali in the 1970s. Jebel Ali now plays a key role in the booming global trade with Asia. "We continued building during all the wars; we took a risk, and it is paying off now," Sultan Ahmed bin Sulayem, Dubai Ports' chairman, said in an interview with *BusinessWeek* last year.

Bin Sulayem, a shrewd government official who has run the ports business for a quarter century, is one of three key advisors to Dubai's ruler, Sheikh Mohammed bin Rashid al-Maktoum. There seems to be no limit to al-Maktoum's aspirations. He has orchestrated the creation of one of the world's largest airlines, Emirates. He r cently inaugurated a new financial cent that is attracting the cream of the world banks. And he has put bin Sulayem charge of a plan to build tourist resorts c artificial islands shaped like palm trees.

ON DECK Miami is part of the P&O package

Dubai Ports at a Glance

OWNER Government of Dubai

CHAIRMAN Sultan Ahmed bin Sulayem

KEY DOMESTIC BUSINESSES Owns and operates giant Port Rashid and Jebel Ali Port in Dubai

INTERNATIONAL ASSETS After its $1.15 billion acquisition of CSX Corp.'s port operations, Dubai runs container terminals in Australia, China, Dominican Republic, Germany, Hong Kong, and Venezuela.

U.S. ASSETS If its $6.8 billion acquisition of Britain's Peninsular & Oriental Steam Navigation goes ahead, it will operate terminals in Baltimore, Miami, New Jersey, New Orleans, New York, and Philadelphia.

Data: DP World *BusinessWeek*

PREMIUM PRICE

BUT PORTS ARE THE heart of Dubai business. In December, 2004, the comp ny bought the port operations of Jac sonville (Fla.)-based CSX Corp. for $1. billion, thus securing facilities in Ge many, Hong Kong, and South Korea. T P&O deal, which Dubai won in a biddi war against Singapore's PSA Internatio al, will vault Dubai Ports from No. 7 to three-way tie for second place amo container-port operators.

By buying P&O, Dubai Ports takes ov management of facilities in New Yo New Jersey, Baltimore, Philadelphia, Mi mi, and New Orleans as well as Britain, Australia, and Belgium. Acco ing to a P&O shareholders' document, t company had a $280 million loss on re enues of $4.8 billion in 2004, whi Dubai Ports earned $330 milli on sales of $570 million. To he finance its expansion, Dub Ports raised $3.5 billion throu a convertible bond issue in Jan ary, and plans an initial public fering. Dubai Ports' Web site li U.S. shipping company vetera on its payroll, such as retiri Chief Operating Officer Edwa H. Bilkey and Senior Vice-Pre dent Michael Moore.

The Dubai Ports World-P deal is far from cheap—t Dubaians paid a 70% premium P&O's stock price. But Davids says the deal will give Du Ports "a wider geographi spread than any other operato

To many in the industry, s clout does not translate into a curity risk. The U.S. ports will main staffed by Americans. U Customs, the Coast Guard, a other authorities, not the termi operators, will have overall con of security. Still, by Feb. 21 hi ranking Republicans had joi in Democrats' calls for Preside George W. Bush to rescind U approval of the Dubai Ports-P deal, while Bush vowed to v any legislation blocking Du Port's ambitions in the U.S. ■

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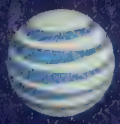

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THE NET

THE SECRET TO GOOGLE'S SUCCESS

Its innovative auction system has ad revenues soaring

BY PETER COY

EVERYBODY KNOWS THAT Google Inc.'s innovations in search technology made it the No. 1 search engine. But Google didn't make money until it started auctioning ads that appear alongside the search results. Advertising today accounts for 99% of the revenue of a company whose market capitalization now tops $100 billion.

Now, research is showing that Google's auction methodology, invented internally and so important for its success, is far more innovative than auction experts once believed. While superficially similar to earlier types of auctions, it is a "novel mechanism" that "emerged in the wild," write the authors of *The High Price of Internet Keyword Auctions,* a new study by Benjamin Edelman of Harvard University, Michael Ostrovsky of Stanford University, and Michael Schwarz of the University of California at Berkeley. Google's AdWords became so successful after its debut four years ago that some of its key features were quickly adopted by Yahoo! Inc., then the search-ad leader.

MATHEMATICAL RIGOR

CLOSE-MOUTHED Google has opened up about AdWords since the three economists cracked its code last November. It freed Hal R. Varian, a Berkeley economist who consults for Google, to publish some of his findings about the auction methodology. And on Feb. 22, Google gave an interview to *BusinessWeek* in which for the first time it named the technical leader of the project: Eric Veach, a veteran of Pixar Animation Studios whose Stanford doctorate was in computer graphics, not economics. "Without his mathematical rigor we wouldn't have been able to do it," said vice-president of product management Salar Kamangar, himself a biology major, who was Employee No. 9 at Google and led the nontechnical side of the project.

Some of Google's innovations are only now being matched. For instance, Yahoo gives the top spot on its search results page to the advertiser who pays the most per click. But Google maximizes the revenue it gets from that precious real estate by giving its best position to the advertiser who is likely to pay Google the most in total, based on the price per click multiplied by Google's estimate of the likelihood that someone will actually click on the ad. Anil Kamath, chief technology officer of Efficient Frontier Inc., a search-engine marketing firm in Mountain View, Calif., estimates that Google earns about 30% more revenue per ad impression than Yahoo does. Kamath says Yahoo is likely to follow Google's lead soon. Asked about that, a Yahoo spokesperson says the company is "currently evaluating" making more use of the "click-through rate" in placing ads. Last fall, Microsoft Corp.'s MSN embraced Google's approach, tweaking it to increase ads' relevance, when it began auctioning search ad space.

What makes Google's auction so different? Auctions come in two main flavors. In a typical first-price auction, participants put in sealed bids, then the winner pays his or her bid. But the danger is the high bidder ends up regretting having won, a effect known as the winner's curse. A second-price auction lessens winner's curse because the highest bidder gets the prize but pays only the minimum necessary to win, namely the second-highest bid, plus perhaps a penny.

Kamangar, Veach, and colleagues chose a second-price auction. But not knowing theory, they designed one that differed in a key respect from the one economists had studied. In the economists' version, bidders always have the incentive to tell the truth. In Google's auction they don't, say Edelman, Ostrovsky, and Schwarz, since in some cases, by understating the top price they're willing to pay, advertisers could get a slightly lower position on the search page for a lot less money. They conclude that naive advertisers who told the truth could overbid. Google's system has plusses for advertisers, too, says Varian. It's easier to understand than the academic version. And it's proven to work on a large scale.

AdWords Select, as it was called at its February, 2002, debut, was actually Google's third crack at an ad auction. The first two were flawed, but Google founders Larry Page and Sergey Brin kept pushing. Even the current system isn't perfect. Advertisers complain that it's too much of a "black box." Still, if the best measure of innovation is commercial success, Google's AdWords was a grand slam. Says Kamangar: "Third time's a charm." ■

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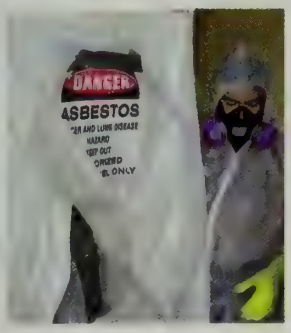
DITED BY RICHARD S. DUNHAM

The Asbestos Mess: Do States Have a Way Out?

JSINESS WAS CRESTFALLEN when a Senate plan to create a $140 llion fund to compensate asbestos victims collapsed on Feb. 14. ut the setback doesn't mean surrender. Even as lobbyists ere ironing out the ill-fated fund's details, their allies were fan- ng out to state capitals to push for a more modest, and win- ble, asbestos fix. The strategy: Write vs giving the sickest victims their due ile shielding—at least for now—com- nies from tens of thousands of claims by ople who were exposed to cancer-caus- g asbestos but show no sign of disease. With insurers and industrial bene- ths leading the charge, this "medical teria" approach to curbing asbestos ims is taking off. Laws are on the books four states and in the works in 14 more. Ve've always two-tracked it" in some tes, says Mary H. Terzino, assistant neral counsel at Dow Chemical. "This med like a helpful backstop."

Workers exposed to asbestos may not ill for decades. So most ims—some 90%, accord- to a 2005 Rand Corp. dy—are filed by people o aren't sick but need to down a marker in court beat the statute of limita- ns. Medical criteria laws through the claims, al- ing asbestos victims h cancer and other seri- lung diseases to move the front of the court- se line. Others retain right to pursue their es later if they start wing symptoms.



PAYOUTS: Under some state plans, only those already ill would qualify

Lawmakers are taking a from state courts. Judges in industrial es began adopting medical criteria r their dockets flooded with asbestos ms in the early 1990s. In 2004, Ohio ame the first state to write them into . Texas, Georgia, and Florida followed. s now are pending in 12 states and are ly to be introduced in two others. "It's rgical way to take the people who are sick out of the system but still be fair hem," says lawyer Mark A. Behrens of Shook, Hardy & Bacon in Washington, who has testified in favor of the legislation on behalf of state Chambers of Commerce.

Trojan Horse

THE AMERICAN BAR ASSN. called for federal medical criteria legislation in 2003, and the concept has the backing of many lawyers who represent seriously ill victims. But critics are cropping up as emboldened business lobbyists use medical criteria bills as vehicles for broader legal reform. A measure pending in Kansas, for example, would eliminate pain and suffering awards for asbestos victims. "They use the criteria issue as a Trojan horse to get into the legislature, then tack on other tort reforms," says Peter A. Kraus, managing partner at Dallas-based Waters & Kraus, which represents asbestos cancer victims.

The state bills are no cure-all for corporations at risk for their use of asbestos. Unlike the trust fund, which would take claims out of courts altogether and grant victims a set award, medical criteria laws don't shield companies from big payouts by outraged juries. The Ohio and Georgia laws are facing legal challenges. And some plaintiffs stymied in medical criteria states simply are filing their cases elsewhere.

Still, the idea resonates with pols under pressure to fix the system. Now, with the trust fund in limbo, many lawmakers in Washington think a federal medical criteria plan might be the next best thing for businesses' asbestos nightmare. Says Senator John Cornyn (R-Tex.): "There needs to be a national solution."

–By Lorraine Woellert

CAPITAL INSIDER

A BRIDGE TOO FOREIGN

CONGRESS says "Buy America," but the Federal Highway Administration is going out of its way to choose Chinese, a Washington State congressman charges. Representative Brian Baird (D-Wash.) says the government is circumventing the law so it can purchase foreign steel for the $6.2 billion project to rebuild the San Francisco-Oakland Bay Bridge to better withstand earthquakes.

"Buy America" rules require that federal road projects use domestic steel unless the materials increase the project cost by 25%. Baird says the FHWA and Caltrans, California's transportation agency, are slicing up the project so the mandates apply to only small portions of the work. Baird has a parochial interest: Bay Bridge Fabricators LLC, a consortium of four Washington companies, will be cut out if Chinese steelmakers supply the 320 million pounds of steel needed.

The notion of Chinese steel sparks outrage

The FHWA is unmoved by Baird's arguments. "The Federal Highway Administration is deeply committed to Buy America provisions in federal law," the agency said in a statement. But because only state funds are being used now, the federal Buy America provisions do not apply. Tony Anziano, toll bridge project manager for Caltrans, says it comes down to dollars and cents: "What we're trying to do is build a seismically safe bridge as quickly and in as cost-effective a manner as we can."

–By Eamon Javers

INDIA

SPREADING THE GOSPEL

Outsourcing's inner circle has deep roots in GE and McKinsey. Here's how they caught the fever

BY MANJEET KRIPALANI

AFTER GENERAL ELECTRIC Co. spun off its outsourcing subsidiary, Genpact, two years ago, Chief Executive Pramod Bhasin figured he wouldn't be seeing much of his erstwhile GE colleagues. But these days, Bhasin sees plenty of the old gang. That's because GE has been so successful with its outsourcing operations that its managers continue to chant the mantra even after they have left the company. Today, GE veterans are in key positions at Home Depot, Honeywell International, Solectron, and United Technologies, among others, giving Bhasin a huge base of potential customers with a deep understanding of just what his company can do for them. "We go after GE alums," Bhasin says.

If GE is the primary source of Bhasin's customers, another outsourcing pioneer, consulting firm McKinsey & Co., has produced many of his potential competitors. Marc Vollenweider, a former partner at McKinsey in New Delhi and London, cofounded Evalueserve Inc., a New Delhi company that provides market research and analyzes data for hedge funds and investment banks. WNS Global Services, a top call center and back-office shop in India, was founded by McKinsey alum Neeraj Bhargava. And Rizwan Koita, an associate with McKinsey in Bombay, left the firm in 1999 at age 29 to found TransWorks Information Services Ltd., which operates call centers and does back-office work for banks and tech companies. After selling that business in 2003 to Indian conglomerate AV Birla Group, Koita established CitiusTech Inc. to serve health-care technology companies. "We at McKinsey saw the opportunity early," says Koita.

Today, veterans of the two companies are powerful evangelists for the benefits of outsourcing. Like Bhasin, many of these managers are eager to tap into informal alumni networks to expand their own businesses and help drive the trend. While there are no numbers, anecdotal evidence suggests that scores, perhaps hundreds, of former GE and McKinsey executives and consultants play key roles as both suppliers of outsourced services and customers for them. "Every time we have an outsourcing forum, it's like a GE and McKinsey alumni association meeting," says Sunil Mehta, vice-president of NASSCOM, India's software industry association.

Of course, lots of companies have seen the opportunities in outsourcing. As early as 1994, American Express Co. an Citibank started hiring Indian accoun ants and math whizzes in Delhi an Bombay. But neither has spread th gospel the way GE and McKinsey hav Insiders and outsiders say the two a unique in their scale, their ability to a tract top performers, their comfort wi multiple cultures and languages, an their commitment to outsourcing. Bo also view outsourcing more as a tool increase growth and boost efficien than as a pure cost savings exercise, strategic insight most other corporatio are only starting to grasp.

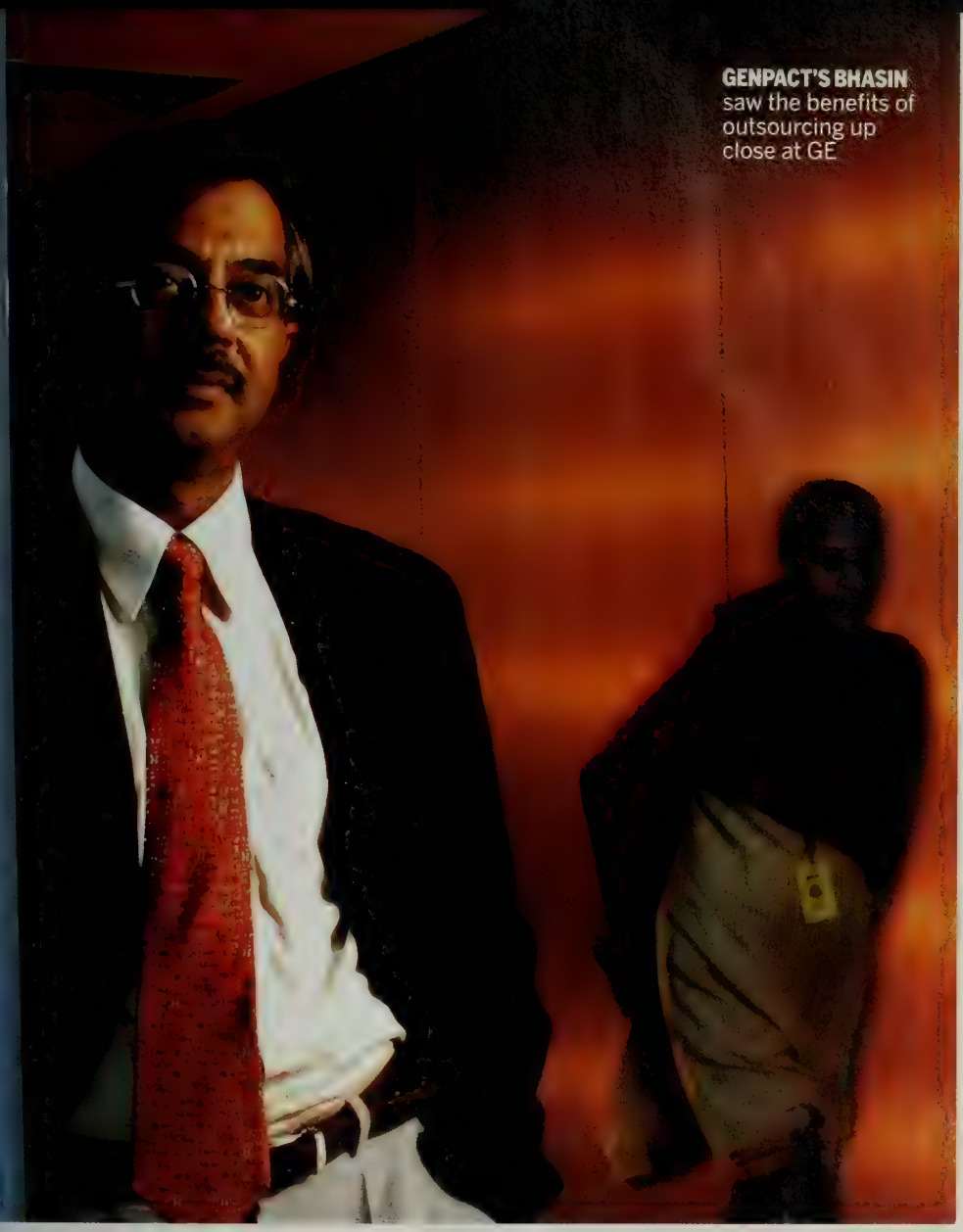
And managers at both companies pra tice what they have long preached. 1996, GE Capital found itself short of t talent it needed to sustain the growth of mortgage refinance bu ness. So it set up a sm support office in De that quickly earned t respect of GE colleagu worldwide. Soon oth GE divisions were clam ing for similar help fr India. That's when the Chairman Jack Welch dered GE divisions acr the company to use o sourcing to streamli their operations. T New Delhi office gr into Gecis Global, wh last year became Genp after it was sold to t private equity groups $500 million. Genp now has revenues of most half a billion a 19,000 employees arou the world.

McKinsey began education with a 19 project on the digi

The Network

The two companies view offshoring as a tool to increase growth. Here are some key players:

	NOW AT	VETERAN OF
PRAMOD BHASIN	Genpact	GE
Honchos one of the world's top outsourcing shops		
MARC VOLLENWEIDER	Evalueserve	McKinsey
Co-founded financial research house		
RIZWAN KOITA	CitiusTech	McKinsey
Has startup that serves health-care tech companies		
MANOJ JAIN	Pipal Research	McKinsey
Does research projects for banks, law firms, and others		
RAMAN ROY	AccessIntellect	GE
Founded outsourcer Spectramind; now on second startup		
ASHWIN ADARKAR	IndyMac	McKinsey
Built 24-hour banking operation by shifting work to India		
ART HARPER	NexGen Capital	GE
Preaches outsourcing as a way of fixing distressed companies		



GENPACT'S BHASIN saw the benefits of outsourcing up close at GE

nomy's impact on serv-
s. The leader of the ini-
ive, Anil Kumar, con-
led that plummeting
communications rates
ld create a world of
note services" whereby
viders in far-flung loca-
s such as India and
na could work for cus-
ers in the U.S. This led
Kinsey to establish
t it called a Knowledge
ter in New Delhi, where researchers
ld crunch numbers, analyze trends,
even put together PowerPoint pre-
ations for McKinsey consultants
ldwide. The Knowledge Center soon
me a model outsourcing operation
McKinsey could show off to clients.

McKinsey's Knowledge Center was the template for today's operations

"We were the first to legitimize the early thinking," says Kumar.

Having seen the benefits of outsourcing up close, ambitious consultants and executives from both companies began jumping ship to start their own businesses. Raman Roy, who helped GE Capital set up Gecis, in 1999 started India's largest independent outsourcer, Spectramind, which he sold to tech giant Wipro Ltd. in 2002. GE, he says, taught him how to seize opportunities, take risks, and make mistakes. "GE is among the best incubators of talent and has a great culture of encouraging entrepreneurship," Roy says. He has clearly absorbed his GE lessons well: Roy is now on another outsourcing startup, Access-Intellect, which does high-end analytics for software companies and others.

Manoj S. Jain, a former McKinsey associate in Chicago, runs Pipal Research Corp. The Chicago outsourcing firm has quadrupled its sales in the past two years and now has more than 100 researchers in India and China doing work for banks, law firms, and others. Jain credits his former employer with being an "idea lab and opportunity shop." Having McKinsey on your résumé doesn't hurt, either. "Clients are willing to give us the benefit of the doubt," he says.

AN EAGER BASE

AS OTHER GE and McKinsey alums have moved on to new jobs, they have started to form an eager customer base for outsourcers. Home Depot Inc. (page 50) CEO Robert L. Nardelli, once a contender for the top job at GE, has hired India's Tata Consultancy Services Ltd. to do call center work and back-office jobs in finance and merchandising and is now trying to create a clone of Genpact for Home Depot. Gunjan Kedia was a partner at McKinsey in Pittsburgh when Mellon Financial Corp. hired her as executive director and asked her to overhaul its back-office operations, with an eye toward outsourcing key functions.

Many of those customers have migrated back to Genpact, a trend Bhasin is happy to encourage. Wachovia Corp. strategist Peter Sidebottom, a former McKinsey partner, helped steer a big outsourcing contract to Genpact. And GE Plastics alum Arthur H. Harper in December launched NexGen Capital Partners, which buys distressed businesses and uses strategic outsourcing—from Genpact—to turn them around. "I know Pramod and I know the team," says Harper. "Of course I'm going to leverage Genpact." ■

–With Brian Grow in Atlanta

SWEET ALABAMA Hyundai will build more cars stateside to boost U.S. sales

SURVIVAL STRATEGIES

THE ROAD NARROWS FOR HYUNDAI

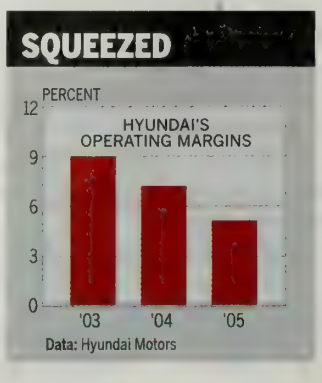
With the rising won and runaway costs choking margins, it has to regroup fast

BY MOON IHLWAN

HYUNDAI MOTOR CO. hardly seems like a manufacturer in distress. At a time when Detroit is barely hanging on, the Korean auto manufacturer's global sales last year climbed 10.8%, to 2.5 million vehicles. In the U.S. they were up 8.7% after surveys showed that new Hyundais match the best Japanese brands in quality. So why has Hyundai Chairman Chung Mong Koo suddenly put his company into "emergency" mode, saying Hyundai's very survival is at stake?

The reason: a profit squeeze. Even as Hyundai's sales have soared, operating margins narrowed to 4.1% in the latest quarter, down from 9.9% in the second quarter of 2004. For 2005, profits fell by nearly a third, to $1.43 billion. Hyundai executives blame a strengthening currency as Seoul has stopped intervening to hold the won down. The won now stands at around 970 to the U.S. dollar, 22% stronger than two years ago and nearly double what it was in 1998. "We've met all the targets in our control: production, sales, and market share," says Senior Vice-President Hwang Yoo No. "But the revaluation of the won has been too fast."

The won's strength comes at a bad time. U.S. carmakers are offering discounts of up to $4,000 on each of their cars, and the Japanese are enjoying a relatively weak yen. Hyundai, meanwhile, is spending like crazy. It raised its research and development budget to $1.75 billion in 2005, more than double 2002's level, and has committed some $3 billion over five years to help parts suppliers improve quality. And its material costs have jumped 20% in the past two years, according to Samsung Securities Co. "The real test for Hyundai management is just beginning," says Samsung Secur ties analyst Ki Hag Ju, who sees margin of ju 3.1% for the qua ter ending in March. "How Hyundai wi control costs in the high-won era w make it go either the Toyota way or t Mitsubishi way," says Hyundai's Hwan



BUFFING ITS IMAGE

MITSUBISHI MOTORS, of course, almo collapsed. So Hyundai is taking a pa from Toyota Motor Corp., which h dodged high costs at home by manufa turing overseas. Of the 2.9 million ca Hyundai aims to sell globally this yea about a third will be built abroad, inclu ing 270,000 Sonata sedans and Santa SUVs due to roll out of an Alabama fact ry Hyundai opened last May. It's boostin output in India and China, and also m open a factory in the Czech Republic.

Hyundai's strategic challenge involv more than ducking the effects of the wo "Hyundai has extremely aggressive sal targets," says J.D. Power & Associat President Stephen Goodall. "The targe are realistic if their quality improv ments can hold up." But quality is cheap, and Hyundai still can't charge t same premium as Toyota. Today t Sonata costs about 10% less than Toyot Camry, though that difference has shru from 15% four years ago.

The only way to close the gap is spend even more buffing its image a improving its lineup. In the U.S., a vamped Sonata and Santa Fe, as well a new $25,000-plus sedan called the Aze are supposed to give the brand a boo Hyundai might also create a new nam plate for its first true luxury model, a re wheel-drive sedan codenamed BH tha expected to make its U.S. debut in 200

The carmaker is attacking costs, too. February it began renegotiating c tracts with hundreds of parts suppliers hopes of cutting prices by an average 10%. On Feb. 22 its 8,100 managers cepted a wage free Hyundai wants its pow ful unions also to accep freeze and greater wo rule flexibility. The uni dismissed the deman as "ridiculous."

Hyundai, a distress company? Not exac But with the won on rise, the carmaker reali it needs to act now. ■

–With David We in Det

In this ever changing world,
Singapore Airlines, you're a great way to fly.
A380
SINGAPORE AIRLINES
APORE · TAIPEI · HONG KONG · TOKYO · SEOUL · FRANKFURT · AND OVER 55 MAJOR CITIES
porean.com

Renovating HOME DEPOT

Skip the touchy-feely stuff. The big-box store is thriving under CEO Bob Nardelli's military-style rule.

BY BRIAN GROW

DON D. RAY IS ONE TOUGH HOMBRE. THE 39-year-old Kentucky native spent three years with the 82nd Airborne Div., one of the U.S. Army's elite units, serving at the head of a maintenance crew during the first Gulf War and an additional seven years on active duty. Then, after the September 11 terrorist attacks, Ray suited up for service again, this time as the commander of a special forces A-team that followed the U.S.-led invasion into Afghanistan. His 12-man squad of snipers, demolition experts, and communications specialists hunted renegade al-Qaeda and Taliban. Combing mountain villages, he grew a thick beard, wore traditional Afghan garb, and rode on horseback to blend in with local Muslims. Ray and his men never killed anyone, he says, but they arrested dozens of suspected militants.

Nowadays, Ray commands a different kind of operation. He has replaced crack-of-dawn physical training and green Army fatigues with sunrise store openings and an orange Home Depot apron. A store manager in Clarksville, Tenn., Ray runs a 110,000-square-foot box with 35,000 products and a 100-member staff, 30 of them former military. Many days start at 4 a.m. That's when he wakes, eats breakfast, catches some CNBC news, then heads to the store, where the doors open at 6. Although Ray's bookish round glasses and pressed khakis make him look more like a teacher than a onetime terrorist hunter, he exudes a steely confidence. Former soldiers on his staff call him "sir." "In the military, we win battles and conquer the enemy," says Ray. At Home Depot, "we do that with customers."

Military analogies are commonplace at Home Depot Inc. these days. Five years after his December, 2000, arrival, Chief Executive Robert L. Nardelli is putting his stamp on what was long a decentralized, entrepreneurial business under founders Bernie Marcus and Arthur Blank. And if his company starts to look and feel like an army, that's the point. Nardelli loves to hire soldiers. In fact, he seems to love almost everything about the armed services. The military, to a large extent, has become the management model for his entire enterprise. Of the 1,142 people hired into Home Depot's store leadership program, a two-year training regimen for future store managers launched in 2002, almost half—528—are junior military officers. More than 100 of them now run Home Depots. Recruits such as Ray "understand the mission," says Nardelli. "It's one thing to have faced a tough customer. It's another to face the enemy shooting at you. So they probably will be pretty calm under fire."

Built like a bowling ball, Nardelli is a detail-obsessed, di mond-cut-precise manager who, in 2000, lost his shot at t top job at General Electric Co. to Jeffrey R. Immelt. He is fo of pointing out that if Home Depot were a country, it would the fifth-largest contributor of troops in Iraq. Overall, some 1 of Home Depot's 345,000 employees have military experien vs. 4% at Wal-Mart Stores Inc. And that doesn't even cou James E. Izen, 38, a lieutenant colonel in the U.S. Marine Cor stationed outside Nardelli's door, is part of a Marine Corps C porate Fellows program that Home Depot joined in 2002.

Importing ideas, people, and platitudes from the military a key part of Nardelli's sweeping move to reshape Home Dep the world's third-largest retailer, into a more centralized ganization. That may be an untrendy idea in management c cles, but Nardelli couldn't care less. It's a critical element of strategy to rein in unwieldy 2,048-st chain and prepare its next leg of grow "The kind of discipli and maturity that y get out of the milita is something that c be very, very useful an organization whe basically you ha 2,100 colonels runni things," explains Cr R. Johnson, preside of Customer Grow Partners Inc., a ret consulting firm.

Rivals such as W Mart are plungi deeper into home i provement produc while archener No. 1, Lowe's Cos., luring Home De customers to its 1,2 bright, airy sto Even as other com nies seek to stoke c ativity and break do hierarchies, Nardell trying to build a disciplined corps, one predisposed to follow orders, operating in high-pressure environments, and execut with high standards. Home Depot is one company that actu ly lives by the aggressive ideals laid out in *Hardball: Are Playing to Play or Playing to Win?*, the much discussed 20 book co-authored by Boston Consulting Group managem expert George Stalk.

The cultural overhaul is taking Home Depot in a marke different direction from Lowe's, where managers describe atmosphere as demanding—but low-profile, collaborative, a collegial. Lowe's does not have formal military-hiring p grams, says a company spokeswoman, nor does it track number of military veterans in its ranks. Observes Goldm Sachs & Co. analyst Matthew Fassler: "Bob believes in a co mand-and-control organization."

In Nardelli's eyes, it's a necessary step in Home Depot's c porate evolution. Even though founders Marcus and Bl were hardly a pair of teddy bears, they allowed store manag immense autonomy. "Whether it was an aisle, department

ORANGE CRUSH
Nardelli's 2,048 outlets rake in $81.5 billion a year

Full Metal Apron

Nardelli is building an army at Home Depot. Here are the new marching orders for America's biggest home improvement store:

Hire Warriors

Home Depot is on a mi hiring spree. The numt former troops hired by Nardelli, who loves the discipline, has risen st from 10,000 in 2003 tc 17,000 in 2005.

Quantify It

Home Depot now mea everything from gross margin per labor-hour store workers to the nu of "greets" at its front Nardelli's predecessor

Marc (left) Blank reliec on ins

store, you were truly in charge of it," says former store operations manager and Navy mechanic Bryce G. Church, who now oversees 30 Ace Hardware stores. And the two relied more on instincts than analytics to build the youngest company ever to hit $40 billion in revenue, just 20 years after its 1979 founding. In the waning years of their leadership in the late 1990s, however, sales stagnated. The company "grew so fast the wheels were starting to come off," says Edward E. Lawler III, a professor of business at the University of Southern California. These days every major decision and goal at Home Depot flows down from Nardelli's office. "There's no question; Bob's the general," says Joe DeAngelo, 44, executive vice-president of Home Depot Supply and a GE veteran.

Although he has yet to win all the hearts and minds of his employees, and probably never will, Nardelli's feisty spirit is rekindling stellar financial performance. Riding a housing and home-improvement boom, Home Depot sales have soared, from $46 billion in 2000, the year Nardelli took over, to $81.5 billion in 2005, an average annual growth rate of 12%, according to results announced on Feb. 21. By squeezing more out of each orange box through centralized purchasing and a $1.1 billion investment in technology, such as self-checkout aisles and in-store Web kiosks, profits have more than doubled in Nardelli's tenure, to $5.8 billion. Home Depot's gross margins inched up from 30% in 2000 to 33.5% last year. But fast-growing Lowe's is still Wall Street's darling, in large part because analysts are only now getting comfortable with Nardelli's strategy. Based in Mooresville, N.C., Lowe's has seen sales grow an average of 19% a year since 2000, and it has narrowed the gap in gross margins vs. Home Depot. Since the day before Nardelli's arrival on Dec. 14, 2000, Lowe's split-adjusted share price has soared 210%. Home Depot's is down 7%.

One way Nardelli plans to kick-start the stock: move beyond the core U.S. big-box business and conquer new markets, from contractor supply to convenience stores to expansion into China. On Jan. 19, Home Depot announced plans to scale back the growth of new stores from more than 180 per year to about 1 The slowdown will let him plow extra resources into beefing Home Depot Supply (HDS), a wholesale unit hawking pip custom kitchens, and building materials to contractors and pairmen. It's a fragmented market worth $410 billion per ye according to Home Depot, where Wal-Mart and Lowe's AWOL and the only competitors are regional companies. ready, Nardelli has spent $4.1 billion buying 35 companies bulk up HDS, and it plans to plunk down a further $3.5 bill to buy Orlando-based Hughes Supply Inc. By 2010, HDS sa are expected to reach $23 billion, accounting for 18% of Ho Depot's total, up from 5% in 2005.

The scope of the task is staggering. Nardelli essence, is building a whole new company— a market twice the size of do-it-yourself tail—to service a prickly customer: prof sional contractors who want low pric great quality, and instant service. S cess in this field will require pinpo execution, and Nardelli knows But his ambitions make some

Work i Progres

Nardelli's discipli is getting financ results, but the st remains stagna

ıe Clear nmands

On Monday afternoons, Home Depot's in-house on station broadcasts *me Page* (shown , a 25-minute live mphasizing the top priorities.

el lerachievers

little room for error at v Home Depot. Weak ers are routinely . Of the top 170 ves, 98% of Nardelli's re new to their ns since 2001.

Centralize Control

Before Nardelli arrived, managers ran stores as individual fiefdoms. Now he is centralizing the operation, spending $1.1 billion on technology that helps to give Atlanta greater control over most tasks.

Borrow Military Ideas

What other company looks to Marine Corps literature for management wisdom? That's what Home Depot Marine Fellow **James Izen** (right) did in helping to craft motivational messages for more than 300,000 store workers.

sts nervous. "He's moving out of retail into services," says borah Weinswig, an analyst at Citigroup. "If it was just retail, ot of us would be more comfortable."

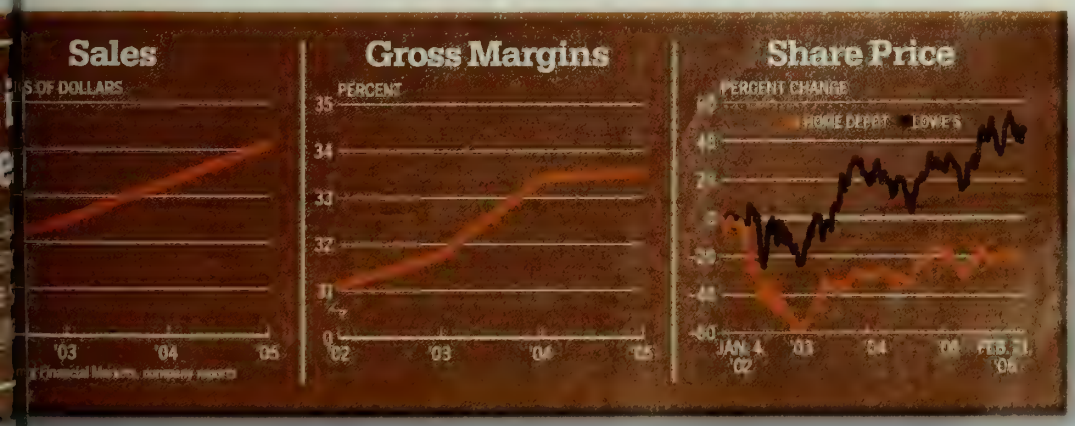
Culture of Fear"

E HIGH STAKES OF HOME DEPOT'S services gambit is one he main reasons Nardelli has pushed his cultural makeover hard in the five years since he has been at the helm. But not have embraced him, or his plans. *BusinessWeek* spoke with 11 mer executives, a majority of whom requested anonymity the company sue them for violating nondisclosure agreents. Some describe a demoralized staff and say a "culture of r" is causing customer service to wane. Nardelli's own bige pay package, $28.5 million for the year ended Jan. 30, 05, rubs many workers the wrong way. His guaranteed us, the only locked-in payout at the company, rose to $5.8 lion in 2004, from $4.5 million in 2003, at a time when me Depot's stock price finished below its yearend price in 00, when Nardelli took over.

Before he arrived, managers ran Home Depot's stores on "tribal knowledge," based on years of experience about what sold and what didn't. Now they click nervously through BlackBerrys at the end of each week, hoping they "made plan," a combination of sales and profit targets. The once-heavy ranks of full-time Home Depot store staff have been replaced with part-timers to drive down labor costs. Underperforming executives are routinely culled from the ranks. Since 2001, 98% of Home Depot's 170 top executives are new to their positions and, at headquarters in Atlanta, 56% of job changes involved bringing new managers in from outside the company. Says one former executive: "Every single week you shuddered when you looked at e-mail because another officer was gone."

As a manager, Nardelli is relentless, demanding, and determined to prove wrong every critic of Home Depot. He treats Saturdays and Sundays as ordinary working days and often expects those around him to do the same. "He's the hardest-working guy you'll ever see," says his former boss, Jack Welch. "If I was working late at GE and wanted to feel good at 9 p.m., I would pick up the phone and call Bob. He would always be there." Privately, Nardelli admits that the move to Home Depot has sometimes been a tough slog. When he first took over—having no retail experience and replacing the beloved Bernie and Arthur—he often felt as though he were fighting a lonely, uphill battle to convert Home Depot's legions of workers to his new vision for the company.

Nardelli's history of surrounding him-



self with military recruits goes back to his GE days. At GE Transportation in the 1980s, he pioneered a program of hiring junior military officers, in part because few people were willing to move to "Dreary Erie, Pa.," where the unit is headquartered. Former grunts, used to sitting in mud holes, found the locale less of a problem. William J. Conaty, senior vice-president for corporate human resources at GE, says: "Places like Erie or Fort Wayne, Ind., didn't look desolate to these guys." Welch soon expanded the program throughout GE.

Welch characterizes Nardelli as "an unusual patriot...a true flag-waving American." Nardelli's father, Raymond, served in Europe during World War II with the Pennsylvania Keystone unit of the National Guard. As a freshman at Rockford Auburn High School in Rockford, Ill., Nardelli joined the Reserve Officers' Training Corps (ROTC) and eventually became company commander and a member of the rifle team. He also played football. "You could either take gym class or ROTC," recalls Nardelli. "I took ROTC and enjoyed the hell out of it." When it came time for college, he applied to the U.S. Military Academy at West Point, N.Y. But the Army academy accepts applicants in part by congressional dis trict, and the young Nardelli missed the cut by one person: H was the first alternate from his region of Illinois. Instead he a tended Western Illinois University in Macomb. After gradua ing in 1971, his draft number was called, but, he says, he did n pass his physical. Later he went on to the University Louisville for an MBA.

As an adult, Nardelli's passion for the military persists. A Home Depot headquarters, 1,800 "blue star banners" hang i the main hallway in honor

employees serving in Afghanistan, Iraq, and elsewhere. He is frequently shadowed by Marine Fellow Izen. During one recent project help Home Depot hone its motivational message to 317,00 store troops, Izen consulted the *Marine Corps Doctrinal Pub cation 1* on "War-Fighting." *MCDP 1*, as it's called in the Marine includes a chapter on "developing subordinate leaders which Izen found a handy guide for Home Depot workers, to "It's about how to out-think your enemy," says Izen.

The military, says Nardelli, trains its recruits to be leade and think on their feet, skills he wants in Home Depot stor "Having personally been on the flight deck of an aircraft car er where 18-year-olds are responsible for millions of dolla worth of aircraft," says Nardelli, "I just think these are fol who understand the importance of training, understand the i portance of 'you're only as good as the people around you.' their case, their life depends on it many times. In our case, o business depends on it many times."

Indeed, the Home Depot of Bob Nardelli is being run wi

Renovating Home Depot

One-on-One with Bob Nardelli: A Q&A with the hard-charging CEO who's making over Home Depot.

Home Depot Supply: How the chain hopes to roll up the lucrative market of selling direct to contractors and builders.

Hardball: A video view with BCG strategy guru George Stalk.

The Story Behind the Story: For a podcast interview with Atlanta Correspondent Brian Grow by Executive Editor John A. Byrne, go to Businessweek.com/search/podcasting.htm

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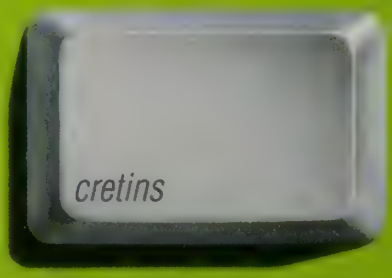

litary-style precision. These days everyone at Home Depot is ıked on the basis of four performance metrics: financial, op- ıtional, customer, and people skills. The company has placed man resources managers in every store, and all job appli- ıts who make it through a first-round interview must then ss a role-playing exercise. Dennis M. Donovan, Home De- t's executive vice-president for human resources and a GE mnus, measures the effectiveness of Home Depot workers using an equation: VA = Q x A x E. Its meaning? According Home Depot, the value-added (VA) of an employee equals quality (Q) of what you do, multiplied by its acceptance (A) in the company, times how well you execute (E) the task. The goal

e "Aprons"
troops," a term used by senior executives to o Home Depot store rs (who wear aprons)

"Bob's Army"
Slang for the "store leadership program," wherein almost 50% of the 1,142 trainees hired are ex-military personnel

"Bobaganda"
The always-on Home Depot television channel, a.k.a. HD-TV, shown in rooms where employees take their breaks

me Despot"
most disenchanted the moniker d on the mighty nprovement chain

"Home GEpot"
A snarky reference to the swelling ranks of General Electric alumni Nardelli has wooed

"Orange Belt"
The entry level for employees studying Six Sigma, the quality management system Nardelli imported from GE

o replace the old, metimes random management style n new rigor. "Bob's creating a second culture [at Home De-]," says DeAngelo.

While Nardelli is careful to say that the military is just one eline of talent into Home Depot—the company also recruits ior citizens through the AARP and Latinos through four His- ic advocacy groups—he is clearly imbuing the company n "Semper Fi" spirit. If Nardelli is the four-star general, then l C. Liebert III is his chief of staff. A graduate of the U.S. al Academy at Annapolis, Md., where he played college bas- all with NBA star David Robinson, Liebert, 40, stands 6 ft., , and is every bit as intense as his boss. After running Six na programs at GE's Consumer Products unit, followed by int at Circuit City Stores Inc., he took over Home Depot's es in the U.S. and Mexico in 2004. Now, with Lowe's and -Mart picking off Home Depot's customers, Liebert is moving quickly to whip the troops into shape. "What worked 20 years ago may not work today," says Liebert. "It's as simple as warfare. We don't fight wars the way we used to."

Simple Slogans

TO WIN THE CUSTOMER SERVICE WAR, Liebert has adjusted his tactics. At the annual store managers' meeting in Los Angeles on Mar. 8, Home Depot plans to roll out a 25-page booklet dubbed *How To Be Orange Every Day*. All store employees will be expected to keep it in their apron pocket. It contains aphorisms such as "customers cannot buy what we do not have," "we create an atmosphere of high-energy fun," and "every person, penny and product counts." Liebert hopes such simple slogans will help shore up Home Depot's once-vaunted customer service. To Liebert's mind, they recall the four basic responses to an officer's question in the Navy: "Yes, sir"; "No, sir"; "Aye, aye, sir"; and "I'll find out, sir." He calls it an effort to "align" all Home Depot workers on the same page when it comes to serving customers. "I think about that line from *A Few Good Men* when Jack Nicholson says: 'Are we clear?' and Tom Cruise says: 'Crystal,'" chuckles Liebert. "I love that."

But drilling workers in how to treat customers may not be enough. The University of Michigan's annual American Customer Satisfaction Index, released on Feb. 21, shows Home Depot slipped to dead last among major U.S. retailers. With a score of 67, down from 73 in 2004, Home Depot scored 11 points behind Lowe's and three points lower than much-maligned Kmart. "This is not competitive and too low to be sustainable. It's very serious," says Claes Fornell, professor of business at the University of Michigan and author of the 12-year-old customer satisfaction survey, which uses a 250-person sample and an econometric model to rate companies on quality and service. Fornell believes that the drop in satisfaction is one reason why

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share

Home Depot's stock price has declined at the same time Lowe's has soared. A former executive who spoke on condition of anonymity says that Nardelli's effort to measure good customer service, instead of inspiring it, is to blame: "My perception is that the mechanics are there. The soul isn't."

Nardelli angrily disputes the survey. "It's a sham," he says, jabbing his finger in the air for emphasis. Nardelli notes that, in 2003, Fornell shorted Home Depot stock in his personal portfolio, before his survey results came out. Fornell says the trades were part of his research into a correlation between companies' customer-satisfaction scores and stock price performance. The University of Michigan banned the practice the next year. Home Depot executives add that internal polling shows customer satisfaction is improving, but they won't release complete results. They point to Harris Interactive's 2005 Reputation Quotient, an annual 600-person survey that combines a range of reputation-related categories, from customer service to social responsibility. The survey ranked Home Depot No. 12 among major companies and reported that customers appreciated Home Depot's "quality service." Still, Home Depot appears to know it has serious customer-service problems. Store chief Liebert's back-to-basics plan includes a push to improve even the "genuineness" of the greeting that customers receive at the door.

Some of the same former managers who blame Nardelli's hardball approach for corroding the service ethic at Home Depot describe a culture so paralyzed with fear that they didn't worry about whether they would be terminated, but when. One night last year, an unnamed executive in the lighting department at Home Depot headquarters left fliers on desks and in elevators containing a litany of complaints about Home Depot, including Nardelli's giant pay package and tl high level of executive turnover. The rebel, say ot er former executives, was tracked down by securi cameras and immediately fired. Citing concer about the employee's privacy, Home Depot declin to comment on the incident. In break rooms, tl company pipes in HD-TV, short for Home Dep television. But employees have mocked it "Bobaganda," referring to Nardelli, for its consta drone of tips, warnings, and executive messages. Eve Monday night, for example, store chief Liebert and To Taylor, executive vice-president for marketing and mercha dising, host a 25-minute live broadcast for senior store staff the week's most important priorities called *The Same Pa* "These are [their] marching orders for the week," says Liebe

Command of Details

STILL, IT'S HARD even for Nardelli critics, including ones has fired, not to admire his unstinting determination to follc his makeover plan in the face of scores of naysayers. They d scribe being "in awe" of his command of minute details. B some of them question whether the manufacturing busine model that worked for him at GE Transportation and GE Po er Systems—squeezing efficiencies out of the core busine while buying up new businesses—can work in a retail enviro ment where taking care of customers is paramount. "Bob h brought a lot of operational efficiencies that Home Depot nee ed," says Steve Mahurin, chief merchandising officer at Tr Value Co. and a former senior vice-president for merchandisi at Home Depot. "But he failed to keep the orange-blooded, e

PLAYBOOK: BEST-PRACTICE IDEAS

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trepreneurial spirit alive. Home Depot is now a factory."

Can his plan work? "Ab-so-lute-ly," says Nardelli. "This is the third time this business model has been successful." He rejects the idea that he has created a culture of fear. "The only reason you should be fearful is if you personally don't want to make the commitment," says Nardelli. "Or there's a bolt of reality that you're in a position, based on the growth of the company, that you can't deliver on those commitments." He says Home Depot is dealing with the challenges of being a more centralized company just fine. And he makes no apologies for laying off the ranks of underperforming store workers and executives to achieve aggressive financial objectives. "We couldn't have done this by saying, 'Run slower, jump lower, and just kind of get by,'" insists Nardelli, hardening his gaze. "So I will never apologize for setting the bar high."

John N. Pistone, 35, is on the elite team. A graduate of We Point and former company commander in the Army's First Ca alry Div., he served in Kuwait in 2000 and was an ROTC i structor at Boston College. Now a district manager runnin eight Home Depot stores on the east side of Atlanta, with 1,20 staffers, he's on the fast track, in part because of his cool d meanor and always-on smile that endears him to employees. " private in the Army is a lot like an $8-an-hour cashier," he say But there's another reason Pistone is on the rise: As he clicl through his BlackBerry on a Monday morning, he remark with a sigh of relief, that his eight stores "made plan" the pr vious week. "This is a quarterly business that we worry abo hourly," he says. As Bob Nardelli builds his new army at Hom Depot, that's a sentiment he loves to hear. ■

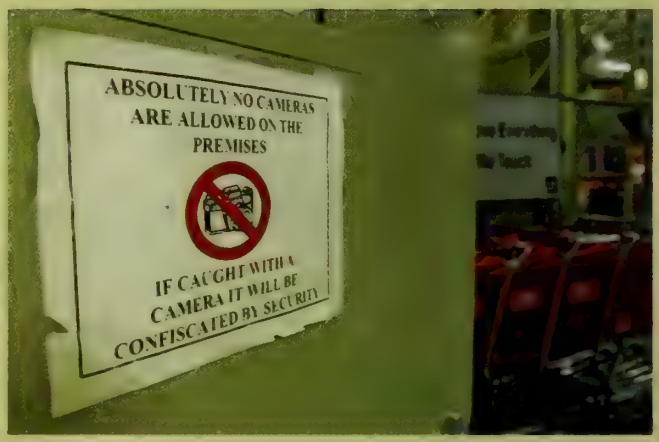
–With Diane Brady in New York and Michael Arndt in Chica

A Lab in a Secure, Undisclosed Spot

In a bland office park not far from Home Depot Inc.'s Atlanta headquarters lies a squat, unmarked building. It could easily be mistaken for the uninspiring home of an insurance firm. That's fine by the steady stream of spit-and-polish Home Depot executives who file through the entrance, many of whom don orange aprons once safely inside. What they don't want you to know is that behind this unassuming facade is Home Depot's secret weapon: an 88,000-square-foot Innovation Center, where the chain tests everything from riding lawn mowers to displays for patio furniture sets before they hit stores.

Since it opened quietly in September, 2004, the Innovation Center has become a key command center in Chief Executive Robert L. Nardelli's push to overhaul the giant retailer. "This is our working laboratory," says Thomas V. Taylor Jr., Home Depot's executive vice-president for marketing and merchandising. Bringing new and better products to its 2,048 stores is critical for Home Depot, in its battle to outinnovate archrival Lowe's Cos., which has its own product testing center on its Mooresville (N.C.) campus, and voracious juggernaut Wal-Mart Stores Inc.

So sensitive is this Home Depot-owned site that reporters are requested not to disclose its address. Hard-nosed Nardelli boasts about how outsiders must pass through a metal detector that scans for camera phones. Once you get past a burly guard stationed at the front door, the Innovation Center emerges as a kind of ersatz, unfinished Home Depot store. Amid soft lighting and wide aisles, 16-ft. racks display vacuum cleaners, power tools, and oven hoods in an effort to learn how they'll look in the real stores. Super-secret projects, in which Home Depot is testing radically new product categories with scant relation to hammers and nails, are watched separately by security personnel and covered with huge tarpaulins.



NO SPIES, PLEASE The Innovation Center lets Home Depot test the water

When Nardelli arrived in 2000, Home Depot had precious little elbow room to experiment. It was risky for executives to tinker with new tools or test-run different types of displays in existing stores, lest they tip their hand to spies from competitors, who are constantly walking the aisles. As a result, they would do demos in the bottom level of a parking garage at Home Depot's headquarters—but the cramped, nine-ft. ceilings made it hard to duplicate the cavernous space of the actual stores.

Now, Taylor and his team have a full-blown Home Depot mock-up to explore new product segments, frequently at blitzkrieg speed. Company officials say they can go from an Innovation Center product test to an in-store pilot project in as little as 30 days. One of the projects soon to make its way out of the Innovation Center: In late March, Home Depot will roll out a special section in 10 stores in Jacksonville, Fla., targeting car buffs with a diverse selection of new products such as Rain-X wiper blades in seven sizes, Master Lock EZ mount towing kits, and Castrol motor oil.

The Innovation Center is also a venue for experimentation. In his relentless drive for "laser execution" at Home Depot, Nardelli has pushed executives to come up with new ways to beat competitors on price, displays, and product assortment. That's why a wall in one aisle at the center is covered, floor to ceiling, with boring white lightbulbs. Each horizontal row of bulbs is set off with tape and labeled with names and price tags: Home Depot, Target, Wal-Mart, Sam's Club, Menard's, and Costco. It's Taylor's marketwide view of what Home Depot is up against—and how, down to the tiniest detail, he can innovate for an advantage.

–By Brian Grow in Atlanta

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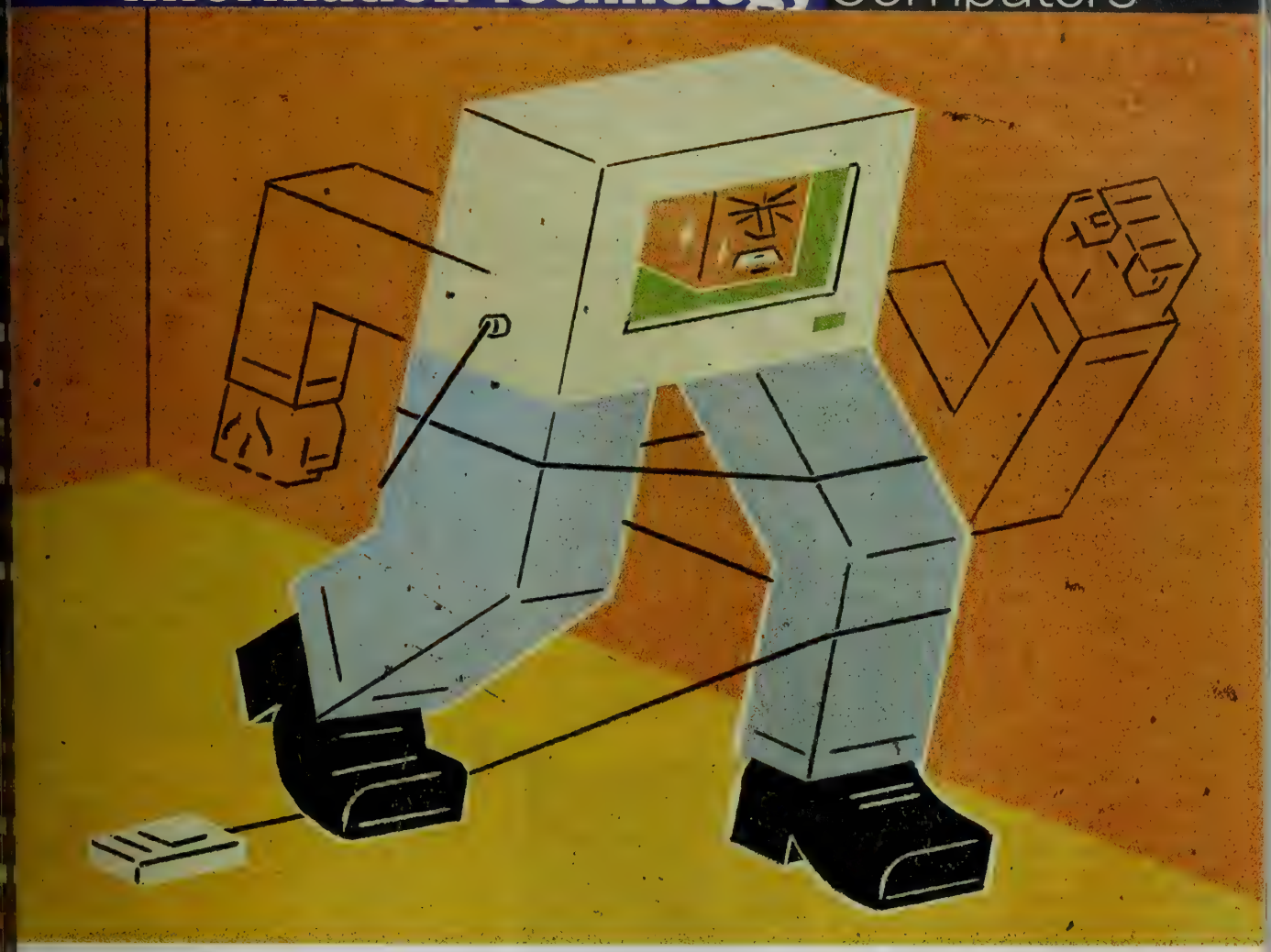

t's Dell vs. The Dell Way

ow the PC maker's once-revolutionary les strategy may be holding it back

LOUISE LEE

DURING A CONFERENCE call on Feb. 16 to announce quarterly results, Dell Inc. executives unleashed a torrent of impressive numbers. Earnings grew 52%, to $1 on. Sales rose 13%, to $15.2 billion. the company said it increased market share, already tops on a global basis, in every region around the world. "Our promise to you is that we intend to grow and take share, as we have historically," said Chief Executive Kevin B. Rollins.

Yet Dell's investors keyed in on another number: Sales growth for the coming quarter would be just 6% to 9%, the company said, a far cry from the 16% Dell posted a year earlier. The following day, Dell shares slid 5%, to $30, bringing the decline over the past year to 25%. On Feb. 22, Dell said it would postpone an annual analyst meeting scheduled for April until September, a move that gives the company more time to improve its performance before the public affair.

For the past 22 years, Dell has laid waste to mighty rivals with one of the most groundbreaking business innovations of the past half-century: selling technology products directly to customers via the telephone, and later the Internet, instead of going through retail stores or resellers. But now the remaining competitors, such as Hewlett-Packard Co., have narrowed the gap in productivity and price.

That leaves Dell in a tight spot. Rollins and Michael S. Dell, founder and now chairman, must either come up with another breakthrough innovation or face a future of slugging it out on near-equal footing with rivals. "Michael broke the paradigm about how to run a computer business, but they haven't been so great at finding the next paradigm," says David Yoffie, a professor at Harvard Business

School. "That's the big challenge for Dell the company and for Michael."

This looks like the year Dell will be pushed harder than ever to reinvent itself. Rollins wasn't available to comment for this story. But he and his top managers are weighing several steps that would represent sharp breaks with the past, including loosening its relationships with Microsoft Corp. and Intel Corp., the two companies most responsible for Dell's dominance in the PC business. Dell is in talks to install key search software from Google Inc. on its computers in exchange for payments of as much as $1 billion over three years. Such a deal is sure to antagonize Microsoft, which has been trying to gain ground against Google in search.

CONSUMER PRESSURE

DELL HAS ALSO reopened negotiations with Intel rival Advanced Micro Devices Inc., according to one well-placed source. Dell is considering offering PCs and servers built on AMD processors, a move that would mark the first time Dell has bought processors for its machines from a supplier other than Intel. The source cautions that talks have been serious in the past and failed, and they could falter again. Yet analysts say what's different this time is the rising pressure on Dell to offer AMD chips, since AMD is swiping market share from Intel. "Customers want AMD," says Charles Wolf, an analyst with Needham & Co. "If Dell doesn't offer their chips, it has less ammunition in the war."

Dell has long been known for its strict financial and operational discipline. But some in the industry say what's needed now is a willingness to experiment, perhaps with larger acquisitions, perhaps with selling through retailers or resellers. "Dell is still singing the same old song," says analyst Mark D. Stahlman of Caris & Co. "It's time for them to change."

The world is clearly changing around Dell. The once-torrid growth in sales of personal computers has slowed, to about 5% a year. More surprising, consumers seem less enamored of buying their tech wares over the Web or phone. According to researcher NPD Group Inc., the percentage of PC sales done via the phone and Web fell last year, and the share of sales through U.S. retail stores rose, as people flocked to shops to fiddle with new gear such as digital-music players, digital cameras, and slick laptops.

Consumers' buying habits are a reflection of a broader shift in the technology world. People are mesmerized by new digital gear with unique features and style. Commodity technologies, such as plain-vanilla PCs, are passé. That's a difficult development for Dell. It spends less on research and development ($463 million) than Apple Computer Inc. ($534 million), despite being four times Apple's size. "Not investing in R&D works great in the commoditized PC world," says Vinnie Muscolino, general partner with Babson Capital Management. "It doesn't work as well in other areas."

That's not to say Dell is broken. It's the global leader in PC market share, with 17.2%, and most analysts expect it to continue to gain share even without any significant changes to its approach. One reason is that Dell has room to expand in fast-growing markets such as China. And Dell is making progress in offering basic computer installation and maintenance services to businesses as well as in reselling back-office storage gear from partner EMC Corp.

But Dell is losing its reputation as a must-own growth stock in the tech field. With its inconsistent financial results over much of last year, several big shareholders have headed for the exits. Citigroup, insurer AXA, and Nicholas-Applegate Capital Management have each slashed their holdings in Dell by 80% in recent months, according to filings with the Securities & Exchange Commission. Dell's market cap has dropped below that of Hewlett-Packard, with HP worth $92 billion and Dell at $70 billion.

Dell's greatest difficulties are related t one of its biggest opportunities: cor sumers. Operating margins for Dell's cor sumer business were an estimated 3.8 in the fourth quarter, despite an attem to reduce reliance on low prices. Whi Dell remains a leader in selling home PC it hasn't made inroads in selling more l crative gear like portable music player "Innovation is now front and center, says analyst Stahlman.

Can Dell get back on track with cor sumers? Job One is to fix its poor reput tion for customer service: The Bett Business Bureau saw complaints mo than double last year, to 1,533. Dell has a ready boosted its support staff in Nor America by 20% and is planning anoth call center in India.

Dell may have to do even more. Son analysts say it's time for the company invest more in R&D to spice up produc That's not happening so far. Dell recent axed one research group assigned to e amine and prepare for future trends.

Putting more money into R&D. Sellir through retail stores. Breaking with Int None of these steps sound anything li Dell. The fact that analysts are raisi these ideas underscores how dramatica ly the times are changing. If Rollins a Dell want to keep up the company's i age as one of the great stock market p formers of all time, they may have think different. ■

A Paradigm Loses Its Punch

Dell remains the world's largest PC maker. But it's nowhere near the revolutionary force—or hot stock—it once was. The reason may be that key assumptions of the Dell Way no longer hold true.

CEO ROLLINS

DIRECT WILL DOMINATE: Dell has long assumed that its major innovation, selling directly to customers over the phone or Net rather than through middlemen, would become even more important as people grew more comfortable buying tech products. But sales in retail stores grew faster than direct sales last year.

WINTEL RULES: Among PC makers, Dell has had the tightest partnerships with Microsoft and Intel, the creators, respectively, of the Windows operating system and Pentium chips that defined the PC. But Microsoft is losing ground to Linux software and Intel to Advanced Micro Devices. Dell may loosen its ties to the tech giants.

COMMODITIZATION IS KING: Dell has never done much of its own R&D, and it recently eliminated a research group assigned to examine and prepare for future trends. But rather than settling for plain-Jane PCs and servers, many customers are looking for more innovative products.

WIN WITH COST-CUTTING: Dell's ruthless efficiency allowed it to underprice rivals and pump up its own profits. Critics have said the company is not spending enough on customer service or new products.

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Merck: Out of the Ivory Tower

Its pragmatic strategy includes tweaking the vitamin niacin to make it a blockbuster

BY AMY BARRETT

MERCK & CO. EXECUTIVES have always taken great pride in the 115-year-old company's long list of scientific firsts. It includes the first measles vaccine (1963), the first cholesterol-lowering statin (1987), and what is likely to be the first vaccine for cervical cancer, now under Food & Drug Administration review. The message from Merck over the years was clear: If it isn't cutting-edge, breakthrough science, it isn't Merck.

That's why analysts and investors were surprised when the drug company disclosed a decidedly un-Merck-like project at a Dec. 15 analyst meeting. The plan was, in essence, to tweak niacin, a well-known vitamin that raises "good" cholesterol, and turn it into a blockbuster. "It's the first time in a long time I've seen [Merck] act practically," says Morgan Stanley analyst Jami Rubin. Such pragmatism will be critical as CEO Richard T. Clark pushes for more efficiency and focus in everything from drug development to sales and marketing to manufacturing. He's candid about Merck's woes. "We were once the envy of the industry," he said at the meeting. "That's not the case today."

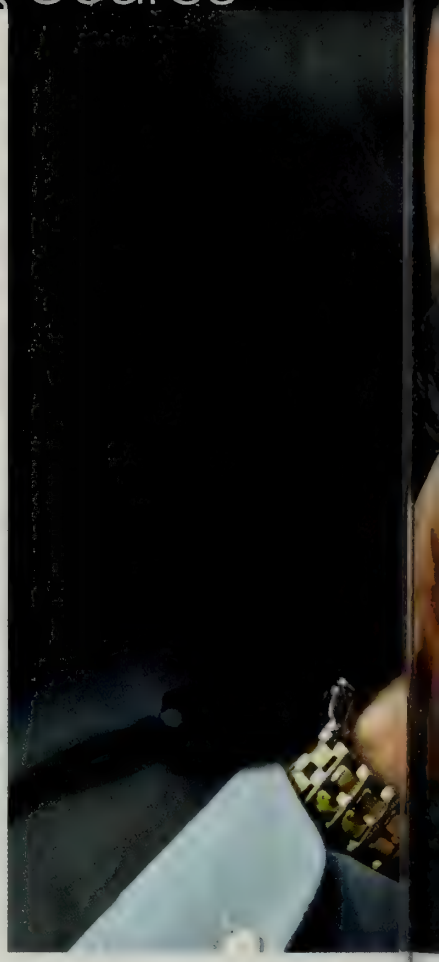
No doubt major change is needed at the once iconic drugmaker. It is facing what some analysts estimate could be a $30 billion liability stemming from lawsuits over the withdrawn Vioxx. That painkiller, of course, was another first—part of an entirely new class of drugs. Adding to the pressure: Two Merck blockbusters must contend with generic competition in the next few years. The biggest hit comes in June, when its $4.4 billion cholesterol-lowering drug, Zocor, loses patent protection in the U.S.

There are promising products in the pipeline, such as Gardasil, the cervical cancer vaccine, but not enough to offset the generics. So while Clark, who became CEO in May, 2005, has said that a $5 billion cost-cutting effort will help Merck achieve double-digit compound annual growth in earnings per share from 2005 to 2010, Wall Street is skeptical. "The numbers just don't add up," says Trevor M. Polischuk, pharmaceutical analyst at asset managers OrbiMed Advisors LLC.

ALLERGY DISCOVERY

WHAT'S CLEAR IS that Merck is leaving behind its ivory tower culture. Under former CEO Raymond V. Gilmartin, Merck steered clear of large deals, preferring to get a product or new technology by buying smaller companies. But last month at the World Economic Forum in Davos, Clark said he was looking for more established businesses, particularly in biotech. Merck is also zeroing in on nine key areas of research, such as heart disease and cancer, rather than trying to cover all bases. It will shift 1,500 reps from selling current products to prom ing new vaccines.

The niacin project is the most strik example of the new approach. Wl drugs such as Zocor and Lipitor d great job of cutting LDL, or bad choi terol, they only slightly boost HDL, good cholesterol. Niacin is much m effective at boosting the good stuff a has been shown to help decrease the r of heart attacks. But the vitamin of triggers uncomfortable flushes. T problem has been mitigated by ne formulations of niacin, but the vitar



Revising the Formula

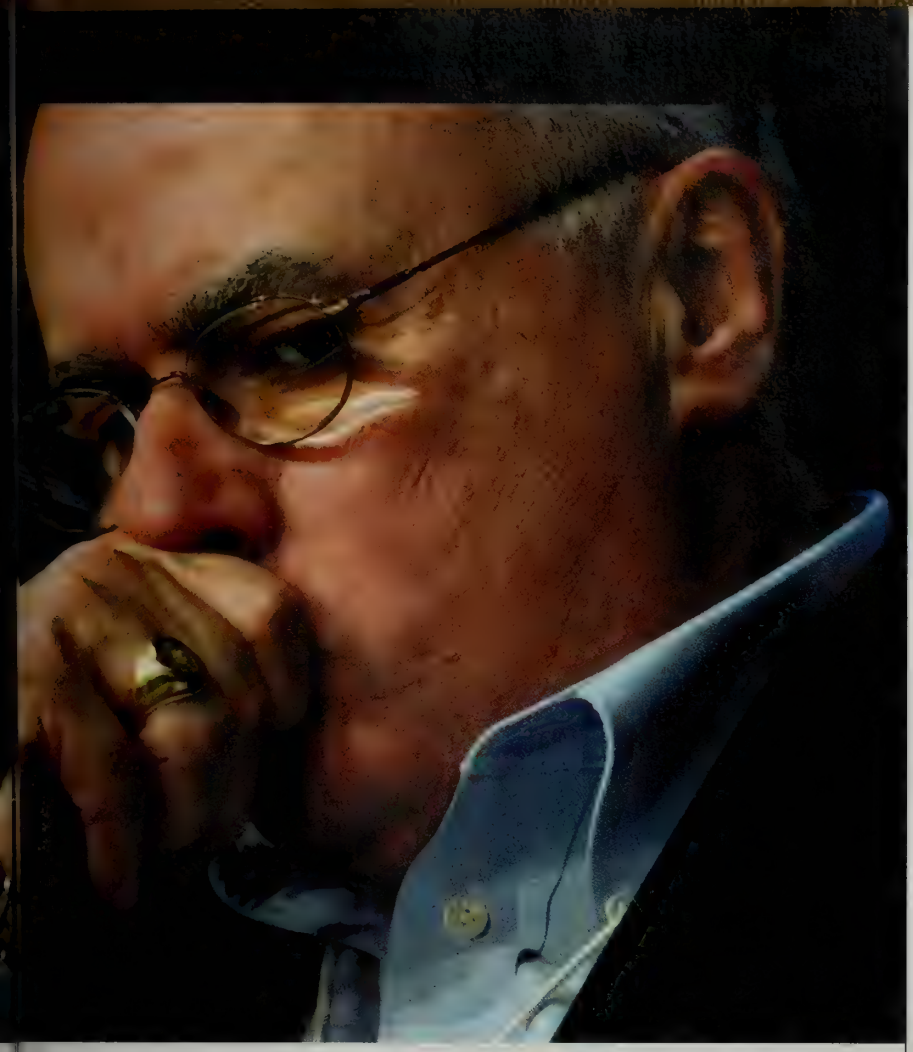
How new chief Richard Clark is overhauling the ailing drugmaker

RETHINKING R&D Rather than trying to cover all the bases in research, Clark is focusing the company on nine key disease areas, including diabetes, heart disease, and cancer.

MORE M&A Clark has said Merck is on the prowl for acquisitions, including deals for established biotech companies. That's a break from the company's previous aversion to larger deals.

CUTTING THE FAT Merck is taking an ax to its cost structure with a goal of generating up to $5 billion in cumulative cost savings by 201

REDIRECTING REPS The company is shifting 1,500 of its sales representatives from selling Merck's older products to promoting its stable of new vaccines.



CEO CLARK Merck could take a big hit from generics

sn't gained widespread use as a way to nbat heart disease.

Merck came to the niacin project in a ndabout way. While executives de- ned interviews about the venture, a kesman confirms that the drug being veloped was first studied as a possible atment for allergies. Researchers had me up with a compound for blocking a stance in the body that plays a role in rgic responses. That substance was o found to be central to niacin flushes. e company is starting late-stage hu- n trials, studying the compound in one with niacin and in another pill with n niacin and its cholesterol-cutting g Zocor.

A HURDLES

RCK IS ACCUSTOMED to leading the k, but this program is an attempted run around rivals that are out in t. Pfizer Inc. is developing a novel L-raising drug called torcetrapib. That g, along with a competing product in elopment at Roche Holding Ltd., rais- good cholesterol differently from in. Pfizer hopes to file its drug for ap- val with the FDA in 2007. But while in's benefits are known, Pfizer and he need to prove their compounds have real cardiac benefits as well. Should the FDA ask for more data, approval could be delayed.

If that happens, and if the niacin combo sails through the FDA, Merck could beat Pfizer to market. But Merck also faces challenges: No other drug exists on the market that blocks the substance targeted by Merck's anti-flushing product, and scientists say much is unknown about the role of that molecule in the body. Sanford C. Bernstein & Co. analyst Richard T. Evans warns that Merck's development program is studying a relatively small number of people, so the FDA may want more data.

Nevertheless, Wall Street is modestly optimistic about Merck's future. A growing sense that Merck can weather the Vioxx storm helped send the stock up 17%, to 35.59, in the past six months. Even if the gussied-up vitamin doesn't take off, it's a sign that Merck can seize a commercial opportunity even when it doesn't have the most dazzling science on the block. "It's sort of like middle age," says SG Cowen & Co. analyst Stephen M. Scala. "You admit you can't do all the things you used to." ■

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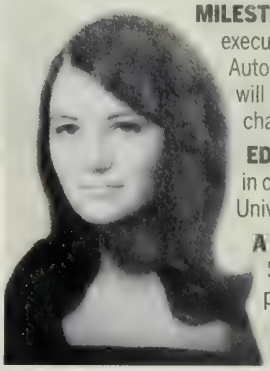
Just Don't Call It Retirement

Carol Bartz is leaving Autodesk in top form. But her days as a CEO may not be over

BIO

Carol A. Bartz

From small-town girl to one of the most important women in tech



BORN Aug. 28, 1948, in Winona, Minn.

MILESTONE Retires as chief executive and president of Autodesk on May 1, when she will become executive chairman

EDUCATION Honors degree in computer science, University of Wisconsin, 1971

A "GEEK" IS BORN She took a computer programming class in 1968 and was instantly hooked.

CAREER PATH Before taking the CEO slot at Autodesk in 1992, she was an officer at Sun Microsystems. Prior to that, she put in stints at Digital Equipment and 3M.

FAMILY Married with three children: Bill, 26, Meredith, 24, and Layne, 17

THE SECRET TO BALANCE "I'm good at flipping the switch," she says. Work remains behind when Bartz departs Autodesk HQ in San Rafael, and she leaves her home life at home, in Atherton.

BY SARAH LACY

AS A GIRL GROWING U on a farm in Alma, Wisconsin town of 80 four decades ago, Car A. Bartz had two caree choices: nurse or teache With big feet for he age—they stopped growing at size 11—sh jokes that being a nurse was out: "Thes boats coming down in white? Can yo imagine?" So Bartz dreamed of being math teacher, even though it was more th math part than the teacher part that ap pealed to her. "At the time, that was all yo could do," she shrugs.

All Bartz wound up doing was becomin one of the most important women in tec As head of Autodesk Inc., the world's leading supplier of design software with an $8.3 billion market cap, she turned an insular, narrowly focused company into a diversified player targeting industries ranging from automotive entertainment. Autodesk, based in Sa Rafael, Calif., isn't a household name, b its software is behind a raft of everyda products, and is used to design building cars, even movie icons like King Kong.

The Best Perfor

For a sense of how highly Bartz is r garded, listen to John Chambers, chief e ecutive of Cisco Systems, where Bartz h had a board seat sin 1994. Chambers tic off her accomplis ments—going from couple hundred milli in sales to $1.5 billion market capitalization that's risen mu faster than the Standard & Poor's 50 stock index, a quality team.

THE BOSS Bartz is proud to run a "real" tech company

Praise like that explains why shock a disappointment ran through techdo when Bartz, 57, announced on Jan. 17 th she would step down as CEO, effect May 1, to become executive chairma She leaves Autodesk in top form. On Fe 28, when yearend numbers are a nounced, revenue is expected to rise so 22%, to $1.5 billion. Profits are expect to top $315 million, up from $47 milli in 2003. Such growth earned Autode the No. 25 spot on the BusinessWeek list of best-performing large companie

Neither Bartz's husband, Bill Marr, n her CEO-in-waiting, Carl Bass (page 6 were sure she was serious about giving the job until she actually told the board Jan. 13. "Until she really did it—until t moment—I didn't know," Bass says.

Over the holidays Bartz wrestled w

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whether it was time to leave. Fourteen years as CEO was a marathon stint in Silicon Valley. Her husband was retired, and her youngest child, Layne, would go to college soon. Before, Bartz could see her daughter between business trips; now she'd have to travel to see her. She knew that if the business stalled again there'd be no way she could back off from a challenge. Also, Bass was getting job offers, and Bartz didn't want to spend another five years grooming a successor.

NO SOFTIE

BARTZ, WHO'S unabashed about her almost maternal love for Autodesk, "cried her eyes out" at the thought of leaving. She never felt she had to choose one "child" over the other, but as a working mom she had to strike a balance between her real and her metaphorical child every day.

Consider this recent morning. She's in back-to-back meetings at a Starbucks near her home, dressed in jeans and an orange sweater, wearing no makeup. Earlier that morning Layne, who's anxiously awaiting responses from colleges, crawled into bed with her, something she hasn't done since she was a child. "She's more stressed than I've ever seen her," Bartz says. "I knew something was wrong and so I just hung." All the while, she knew the clock was ticking on a breakfast meeting she had scheduled. She comforted her daughter, threw on clothes, and raced out, already late. "The concept of balance is perfection," she says, miming a seesaw motion. "And that's crazy."

Bartz may have cried about moving on, but she's no softie. She prides herself on running a "real" tech company, bristling when put in the same camp as eBay Inc.'s Meg Whitman, who some say runs a retailer. And she's blunt. "If she thinks you're stupid, she'll tell you," says Alfred S. Chuang, CEO of BEA Systems Inc., who worked under Bartz at Sun Microsystems Inc. Bartz doesn't mind being singled out as a top woman in tech: "Let's face it, I don't believe the CEO of Autodesk would be invited to be on the President's Science & Technology Council if she wasn't wearing a skirt."

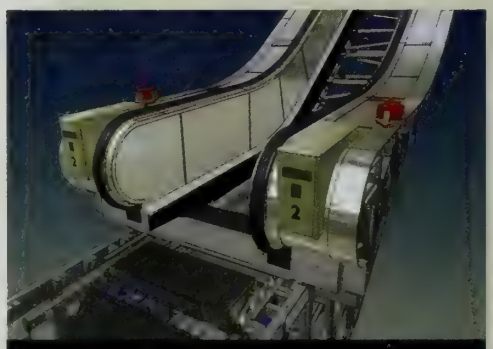
What's next? Bartz won't allow her staff to even use the word "retirement." She's booked solid with Autodesk duties through next January, and begins teaching a Stanford Graduate School of Business class in March. Those close to her suspect her days as a CEO are not over. "If you told me that one day she'd be CEO of one of the largest tech companies, I wouldn't be surprised," says Chuang.

SUCCESSION

From the Doghouse To the Corner Office

Following Carol A. Bartz won't be easy, but at least Autodesk Inc. employees know that incoming Chief Executive Carl Bass has the technical chops for the job. He founded a company that was acquired by Autodesk in 1993, and he quickly became one of the company's top engineers.

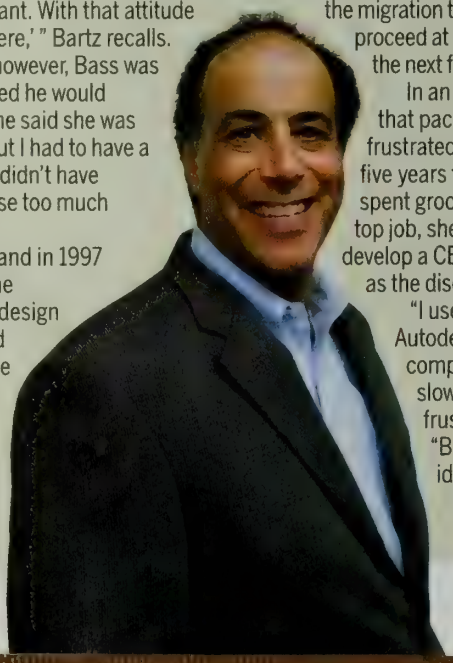
Employees can also be sure he won't shy away from confrontation. Bass, 48, used to roam the Autodesk halls in Birkenstocks and shorts, criticizing the company for not moving fast enough.



IN 3D New software cuts mistakes and costs

That attitude led Bartz to fire him in 1995, prompting a panicked call by the head of engineering. "He said, 'You can't fire Carl,' and I said, 'Excuse me? I can do whatever the hell I want. With that attitude we don't need him here,' " Bartz recalls. A few months later, however, Bass was back, having promised he would change his ways. "She said she was happy to have me, but I had to have a real job, because if I didn't have enough to do I'd cause too much trouble," Bass says.

So he kept busy, and in 1997 wrote a version of the signature AutoCAD design software that helped the company bounce back after the hohum reception to an earlier release.



BASS The new CEO has a strong tech background

Bartz leaves Bass with a company that has solidified its position as the industry-standard design software for engineers and architects. His task is to continue Autodesk's push from the two-dimensional world of blueprints and floor plans to the 3D realm. New iterations of software allow customers to see a virtual model, rather than looking at overlapping lines on a computer and having to visualize in one's head how, say, a piece of machinery would work in three dimensions. The software cuts down on time, mistakes, and costs, say customers like William L. Harrison, manager of engineering R&D at Cincinnati-based manufacturer Planet Products Corp. He's using Autodesk's software for a $3 million project to build a machine that will sort and package White Castle hamburgers at the torrid speed of 20,000 burgers per hour. "I'll never go back to 2D," he says.

The secret to Autodesk's success isn't bleeding-edge technology—it's bringing new software to the masses at a low price point, and bringing it to them when they're ready. So while competitors have had 3D software on the market longer than Autodesk, its products are about a tenth of the cost and are easier to use. So far, less than 15% of customers have made the upgrade to 3D, which Bass says is fine with him. He expects the migration to its 3D product to proceed at a steady pace over the next five years.

In an earlier incarnation, that pace might have frustrated Bass. But in the five years that Bartz has spent grooming him for the top job, she has helped him develop a CEO's polish as well as the discipline.

"I used to think Autodesk felt like a big company and moved slowly, and it was frustrating," he says. "But I've learned the idea of patience."

–By Sarah Lacy in San Mateo, Calif.

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From Dinosaur To Dynamo?

Thanks to CEO John Thain's reforms, the NYSE's future suddenly looks promising

BY JOSEPH WEBER

NO WONDER JOHN A. Thain turned them down flat when leaders of the New York Stock Exchange first broached the idea of his taking over as chief executive officer in late 2003. Back then, the NYSE was reeling from scandal over the gargantuan pay package for ousted Chairman and CEO Richard A. Grasso. The feds were closing in on middlemen on the trading floor who they believed were ripping off customers. And amid it all, the hidebound old exchange was losing business as technologically superior rivals won over traders and companies alike. Thain, then president of Goldman, Sachs & Co., said no thanks. "Why would I ever want to do that?" he says.

But then the leaders sounded exactly the right notes. The NYSE is crucial to the U.S. and global market systems. It's in big trouble. And, dangling the perfect inducement to a guy who styles himself as a problem-solver, they told him how it would be a great challenge. Reform-minded director and now Chairman Marshall N. Carter even cooked breakfast for Thain one fall morning in his upper East Side apartment. A lecturer at Thain's two alma maters, Massachusetts Institute of Technology and Harvard University, he pleaded that the NYSE badly needed someone who could blaze a "path to the future" and "restore confidence and trust." Thain couldn't resist. He quit his $20 million-a-year post at Goldman to take the $4 million NYSE job.

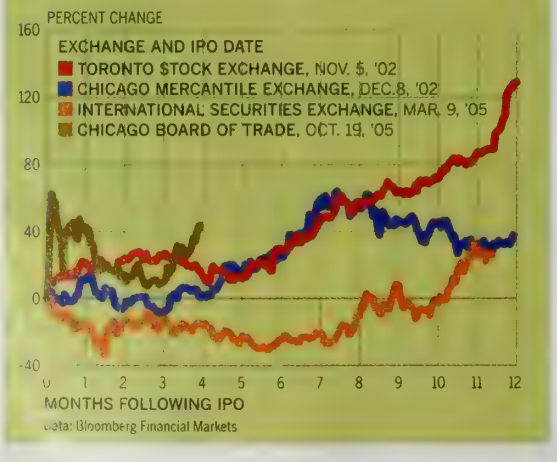
Now, as the NYSE stands on the brink of going public through a merger with all-electronic rival Archipelago Holdings Inc., known as Arca, it looks as if Thain's move was smart for both parties. Arca's stock price has soared about 260%, while the NYSE's seat prices have jumped threefold. The 50-year-old Thain, an electrical engineer by training, may prove to be the savior of the hoary old trading floor even as he pushes its technology to the exchange world's cutting edge. Traders may still start their days in a cozy member's club where stuffed animal heads gaze down at them, but they'll increasingly make deals on wireless devices that will make BlackBerrys seem outdated.

The 213-year-old exchange's future, very much in doubt a few years ago suddenly promising. Thain's NY could become a global powerhouse t dominates markets far beyond U based blue chips. In his vision, the n NYSE could be a one-stop shop where vestors can buy global stocks, futu options, exchange-traded funds, a bonds. It could challenge the pow house Chicago futures markets a with a new place for hot young com nies to list, could steal much of the th der of U.S. rival NASDAQ. It could e own a European exchange.

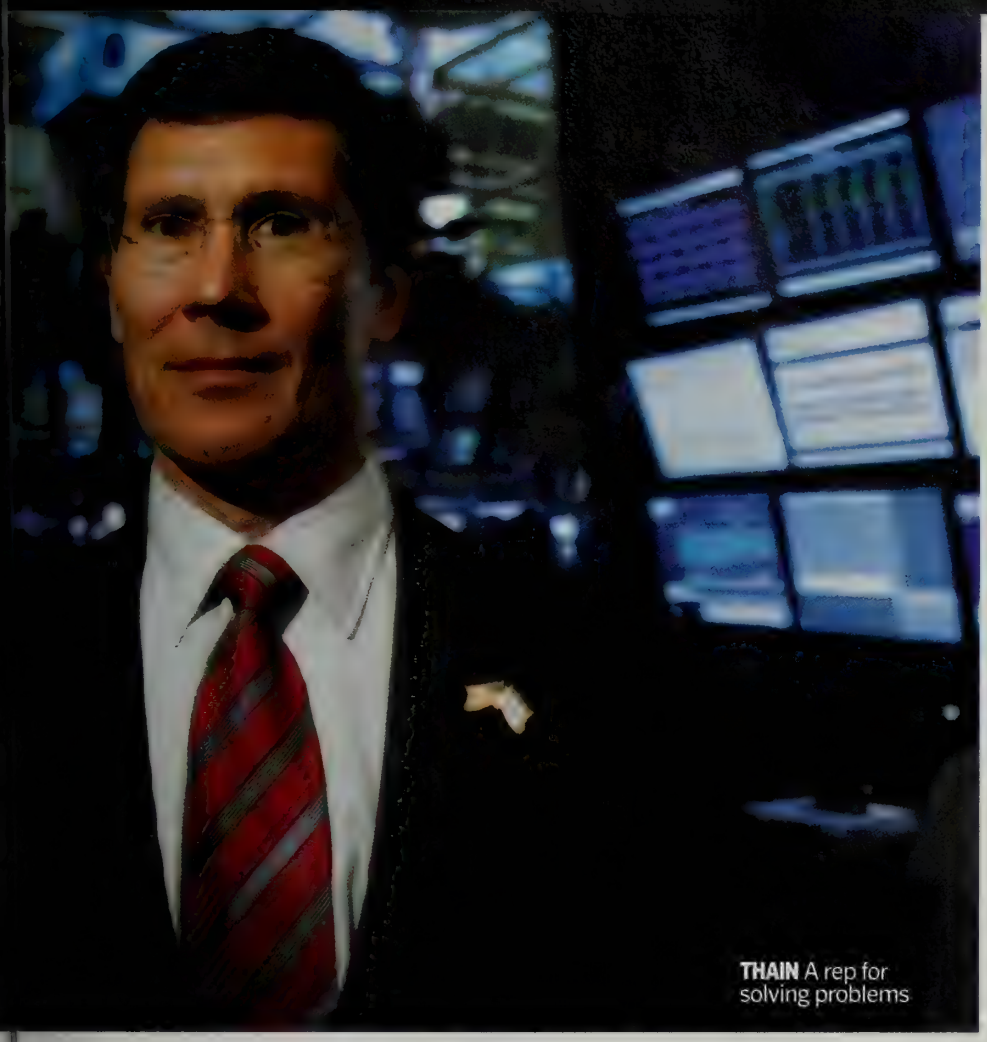
Of course, that rosy future isn't a s thing. NASDAQ and others are wait for a slipup. "Competitors are lick their lips at what they see as a once-i lifetime opportunity to steal volun says market expert Benn Steil, directo international economics at the Cou on Foreign Relations in New York. ready, smaller outfits, such as big bl trading broker Liquidnet Inc., are c ing out growing chunks of trad business. The NYSE's market share c tinues to slip, as it has since about 19 And national borders, along with W

IT PAYS TO GO PUBLIC

Most publicly traded exchanges have fared well in the first year after their IPO



Data: Bloomberg Financial Markets



THAIN A rep for solving problems

on regulatory fiefdoms, still matter. hain has plenty of minefields to cross. the Securities & Exchange Commis- impose tough conditions on the ipelago merger? Could technical hes unsettle his modernization ef- s? Might rivals make trading so cheap investors flock to them? Even un- seeable scandals or a backlash from in the NYSE ranks could derail his s. "To some extent, he's fighting the cy culture at the NYSE, a culture that feels the NYSE is really the go-to ex- ge and there's no reason to fix it be- e it wasn't broken," says Richard A. , an analyst at the investment firm of e, Bruyette & Woods Inc.

t odds are good that the reserved, tly shy Thain will pull off most of his e plan in the three more years he's g himself in the post. Even critics the straitlaced CEO, who hails from Antioch, Ill., high marks for rebuild- he NYSE's credibility with regulators were furious at predecessor Grasso's million payday. By agreeing last to pay $20 million for regular audits regulatory program and to install video cameras to police the trading floor, the NYSE also has moved past the nasty scandal involving at least 20 former middlemen—so-called specialists—who the SEC said enriched themselves at a cost to investors of $158 million between 1999 and 2002. Thain doesn't expect such blots on the NYSE's record to endanger the outfit's self-regulatory plans, even as the SEC debates calls from the likes of the Securities Industry Assn. to mesh NASDAQ's regulator, the NASD, with the NYSE's self-regulatory unit.

"HYBRID" SYSTEM

MORE IMPORTANT, Thain, who took his post in January, 2004, has rushed to modernize the trading floor—even if some people joke that he's dragging it into the 20th century. The key is his plan to take NYSE public by merging with the technologically superior Archipelago, a deal that won overwhelming backing from NYSE members in December. The bourse is now on a growth path—which is why optimists bid up the price of seats on the NYSE from less than $1 million early last year to $4 million now. The believers also hiked Archipelago's stock from under 17 a share last April to more than 60 now. Thain is "bridging the worlds of technology, market structure and policy in a way that is very compelling," says Timothy F. Geithner, chief executive officer of the Federal Reserve Bank of New York.

By persuading NYSE members to accept the Archipelago deal, Thain will close the door on the exchange's private-club structure. Soon after the merger is O.K.'d by the SEC—and that could happen any day—Archipelago's stock will be rechristened NYSE Group Inc. (ticker symbol NYX), and holders of the NYSE's 1,366 seats will become shareholders. Soon after, outsiders will be able to buy the NYSE Group stock by way of a secondary public offering.

Getting this far is in many ways a testament to Thain's persuasive talents. He convinced specialists that they needed to accept a new trading system that will shrink their roles sharply if not render them obsolete. Thain, who once oversaw tech operations at Goldman, has pushed a computer-human "hybrid" system that will give investors choices. Those who want their trades handled by specialists, figuring they'll get better prices that way, can ask for them. Those who value speed can route their orders to the NYSE's computers for instant matching—the same kind done on NASDAQ or Archipelago. Investors will still be able to send their trades to ArcaEx, Archipelago's superfast system, which for now will operate separately from NYSE's.

Outside pressures helped Thain sell exchange members on the changes. Before he joined the NYSE, rivals such as Archipelago—whose leaders once mocked the NYSE as a dinosaur—were nibbling at the Big Board's trading volume. The SEC was also threatening to foster the growth of alternative markets by pushing a rule, now slated to go into effect in June, that would require that each stock trade be routed electronically to the market that offers the best price. With all that, specialists could see extinction if they didn't find ways to keep business in New York. "Specialists have always been very adaptable," says Robert B. Fagenson, vice-

chairman and CEO of Van der Moolen Specialists USA LLC, one of seven remaining specialist firms on the floor.

While the middlemen are hoping they'll do better as volume surges, plenty of observers expect them to fade away as investors insist on fast electronic trades. Thain's hybrid, they argue, will prove little more than a short-lived sop to the specialists. "The hybrid will die a swift and merciless death," argues Harold S. Bradley, chief investment officer for the mutual fund firm American Century Investments in Kansas City, Mo. "It's basically a quaint last bit of respect for a dying and anachronistic way of doing business."

Thain plans to boost NYSE's arsenal of products

But Thain echoes a timeless refrain: that the floor folks give the NYSE a big edge over fully automated exchanges. By standing ready to buy volatile stocks, they can stop erratic plunges and keep markets moving when sellers can't find buyers. They will also keep markets lively in less-traded stocks, which Thain expects will be their forte.

Whether he actually believes that or not, Thain's changes don't depend on the specialists' survival. Armed with Archipelago's superfast computers and the NYSE's enhanced ones, the exchange could do fine without human intervention. So long as the cost of trading remains low, Thain is betting, buyers and sellers will keep flocking to the NYSE.

The approach mirrors the one the hugely successful Chicago Mercantile Exchange took a couple years ago, when it moved to a trading system that's now mostly electronic, along with converting from a member-owned operation into a public company. Thain was so impressed by the CME, in fact, that he welcomed former CME Chief Executive Officer James J. McNulty as an NYSE director.

The CME's popularity with investors has impressed Thain, too. After going public at 35 a share in December, 2002, the CME's stock now fetches around 422. Will investors ride a similar rocket with the NYSE? Unlikely. The CME, unlike the NYSE, has a monopoly on trading in its futures contracts, whereas investors can buy or sell NYSE-listed stocks on lots of exchanges. What's more, the CME creates products at the drop of a hat—recently launching snowfall futures, for instance—while the NYSE for now is largely stuck with equities. That's partly why Thain plans to pump up the NYSE's arsenal of products with futures, options, and fixed-income securities.

Archipelago, too, has been a role model for the NYSE chief. Coming from nowhere in the late 1990s, it now controls about 20% of the volume in NASDAQ-listed stocks and a smidgen of NYSE-listed trading. Since Goldman was one of Arca's main financial backers, Thain watched the company's rise from a ringside seat. He tapped seve Arca executives for top spots at the NYS Integrating them into the NYSE team w be challenging. But in the end, they likely give it some sorely needed verve.

Thain chose Archipelago as the vel cle to go public. Now he's planning wield it against NASDAQ. Arca gives hi control of a big chunk of trading volur in NASDAQ-listed stocks. Thain also c use the exchange to woo young comp nies that don't yet meet the NYSE's hi listing standards. His hope is that A will serve as a farm team for the M crosofts of tomorrow. Finally, Arca giv him an instant inroad into options adding the Pacific Exchange, whi Archipelago owns.

BIGGER GAME

THAIN'S BIGGEST challenge will be pull off his management integration, technological innovations, and the tra formation into a publicly traded compa all at the same time. "It's like changin Ford into a Honda while driving do the road at 55 miles an hour," s Georgetown University associate prof sor James J. Angel.

Thain shrugs off worries about his U rivals. He is stalking bigger game, eye European exchanges such as the Lond Stock Exchange, Euronext, and Eu "There will be consolidations between U.S. and Europe, and want to make sure w well positioned to be leader in that consoli tion," he says. Such a m could ease the problem foreign companies forgo U.S. exchanges because regulations such as the S banes-Oxley Act. Of cou getting clearances fr U.S. and foreign regulat to snap up a Europ bourse won't hap overnight or possibly at

For investors eye NYSE shares, Thain's p is surely ambitious. Yet has already moved fast ward creating his vision global marketplace wh many products will trad lightning speed. Even i gets only halfway th investors should find trip rewarding. ■

IN THE FRAY Thain (center) is modernizing the floor

BusinessWeek online
For more on John Thain, vi
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CHRISTIAN BAHA
Superfund CEO

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Baha claims h
didn't know ab
Monaco's stat
as a tax haven

In the $1.1 trillion hedge fund industry, hype is up, returns are down, and the smart money is getting picky. Former Vienna cop Christian Baha thinks now is the perfect time to promote his $1.7 billion "virtual hedge fund." Price of admission: $5,000.

Welcome to Superfund, which you'll soon be seeing advertised on TV...

BY DIANE BRADY

SO MANY OTHER PEOPLE DURING THE 1990s, ANTHONY don bought an eclectic range of stocks and watched with zement as his portfolio bulged. By 2000 he had holdings h $1.8 million. "I was elated but unnerved. It didn't seem nal," says the photographer, who lives in a loft apartment in hattan's trendy SoHo neighborhood. Then the bubble t, taking Gordon's tech- and telecom-heavy portfolio down value of $80,000 by 2001, a disaster that he blames on his er. "The guy told me I had the equivalent of a diversified al fund, but he didn't rebalance," Gordon says. Suddenly market was no longer his friend. "I became cautious, weary, ous, and concerned."

t not so cautious that his interest wasn't piqued two years when a fellow airplane passenger mentioned something d Superfund. Then he saw a cable-TV commercial in which ng man with a long, dark jacket and a clipped accent rem- ent of Arnold Schwarzenegger's said "*Guten Tag*." The on the screen introduced himself as Christian Baha, the der of Superfund. After acknowledging that viewers "prob- have no idea" what kind of investment he was promoting, added that "regulations prevent me from describing it on sion." Gordon, who is now 42, wasn't wowed by the ad's istication: "I would have had him wearing a headset in front of four or five computer screens, not using a phone with a cord and a little laptop." But Baha's pitch of hedging against another potential stock crash, especially at a low cost, appealed to him. He put $5,000 in Superfund and has since invested $22,000 more.

Gordon was an early catch when the Austrian fund entrepreneur first probed the U.S. market in late 2002. Now, Baha is pumping up his marketing in the U.S.—including new TV ads in March—and trying to capitalize on consumer fascination with "alternative" investments amid a largely stagnant stock market. Hedge funds have headlined the alternative craze, which is the hottest investment trend since the dot-com runup.

So it's no wonder that Baha in an interview describes Superfund as "virtually a hedge fund." It's also one with a distinctly show-business sensibility. In Europe, Superfund draws attention by sponsoring professional soccer, basketball, and Formula One racing teams. "This is seen as a hedge fund for the average person," says paid spokesman Niki Lauda, the retired Austrian driving legend. None of Superfund's rivals in the U.S. can brag that they underwrite celebrity-award shows honoring the likes of *Desperate Housewives* star Teri Hatcher and designer Donatella Versace. Baha also takes pride in his unconventional career path: Before he got into the fund business, the

voluble 37-year-old worked as a beat cop, patrolling some of Vienna's tougher blocks. Last year he opened a sparkling 7,000-square-foot investment center on Manhattan's Fifth Avenue.

Baha may be more flamboyant than his better-known U.S. rivals, but he embodies a new and frenzied atmosphere in which fund companies from Merrill Lynch & Co. to Charles Schwab are trying to lure the less-than-wealthy into the hazardous realm of alternative investing. Superfund Group, to be precise, offers managed futures funds, which let investors make such esoteric plays as shorting currencies and betting on cattle prices. It's a strategy used by some hedge funds, and the two types of investment vehicles are close enough cousins that many financial firms lump them together. Based in Monaco, Superfund boasts $1.7 billion under management and 370 employees in 19 offices around the world. As do hedge funds, it charges steep incentive fees while promising high returns regardless of broader market conditions. Both types of funds tend to favor secretive, risky investing methods. Gordon, the New York photographer, like other Superfund investors, doesn't know what markets his money is in. "You have to have trust," he says.

The alternative-investment boom has reached a critical juncture. After a rush of new money and soaring returns from 2000 through 2004, many hedge and managed-futures funds floated back to earth last year. Financial advisers say the institutions and wealthy individuals traditionally drawn to alternative investments have grown leery. The $1.1 trillion hedge fund industry saw net outflows in the fourth quarter of 2005, and fund tracker Barclay Group reports that the $130 billion managed-futures business shrank by 1% for the year. But as the smart money starts to pull back, Baha and scores of competitors are amplifying their appeals to smaller investors such as the trustful Gordon.

Superfund's main fund lost 10% in 2005. It has a name that many Americans associate with toxic-waste sites. And yet coming next month, along with the new wave of U.S. TV commercials, will be a national print-advertising campaign, a series of investor seminars around the country, and direct mailings to 600,000 brokers and advisers and to millions of potential customers. Imitating a stunt he has employed in Europe, Baha is building a mobile investment office that will travel across the country on an 18-wheel truck.

Only 4,000 of Superfund's 50,000 investors worldwide are Americans, but Baha cheerfully emphasizes that the U.S. client base grew by one-third last year. Nothing if not upbeat, he stresses that most of his customers saw gains of at least 7% in the month of January, easing the pain of last year's losses. "People pay attention to performance," he says, playing down S perfund's volatility. "Everybody who invests in stocks would much better off to invest in hedge funds."

He has plenty of company in the U.S. among purveyors of a ternative funds trying to entice smaller investors. Hedge func which are only lightly regulated, typically set investment mi imums at $250,000 or more. They are required by law to lin their individual clientele to people with a net worth of at lea $1 million, or $200,000 in annual income for the previous tw years—itself not such a daunting hurdle anymore.

But big names such as Merrill Lynch and Deutsche Bank a inviting investments as small as $25,000 in funds that invest hedge funds. Charles Schwab, UBS, and other major firms minimums even lower for mutual funds that are designed mimic hedge funds. Superfund, meanwhile, welcomes inve ments beginning at only $5,000, a stark break from the typi minimum in managed futures of $50,000 to $250,000.

The situation makes some financial veterans nervo

Playing the Hedge Game

Some of the varieties of "alternative" investments

HEDGE FUNDS

Lightly regulated private investment pools that limit clientele to institutions and individuals who have earned at least $200,000 a year for the past two years ($300,000 for a couple) or have a net worth exceeding $1 million. Roughly 8,600 funds hold $1.1 trillion in assets. Marquee names include George Soros, Steven Cohen, and Carl Icahn.

FUNDS OF FUNDS

Funds that take stakes in hedge funds, charging an extra layer of fees, with minimum investments as low as $25,000. If registered with the SEC, they can accept as many investors as they want. Funds of funds account for roughly $395 billion, or 36% of all hedge fund assets. Among the players: Citigroup, Morgan Stanley, and OppenheimerFunds.

MUTUAL FUNDS THAT MIMIC HEDGE FUNDS

These funds loudly market that they short stocks, take on illiquid investments, and adopt other aggressive strategies used by hedge funds. They also charge higher fees. Cost of entry can be as low as $1,000. This is a $300 billion business populated by such companies as Charles Schwab, UBS, and Janus.

MANAGED FUTURES FUNDS

A $130 billion industry with minimum investments starting as low as $5,000. **The goal: Use highly leveraged futures contracts to bet on everything from the demand for corn and cattle to the direction of the dollar and global stock markets.** John W. Henry & Co., Campbell & Co., and Superfund Group are among the best-known.

Data: Hedge Fund Research, Barclay Group, Hedge Fund Alert, Cerulli Associa

"There's this belief that truly smart people have [investme exposure to hedge funds," says Wendell L. Perkins, the 43-ye old chief investment officer at JohnsonFamily Funds in Rac Wis. "You have to ask if a whole lot of folks are investing wh they shouldn't be."

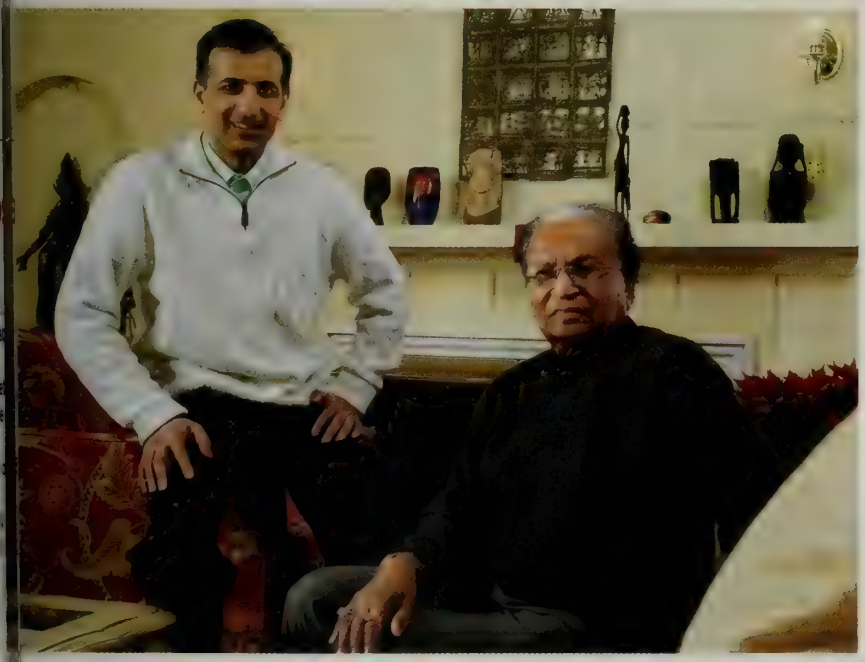
Superfund's U.S. managing director, Aaron Smith, 26, patiently rejects such suggestions. "It's offensive to me to s gest that someone's net worth correlates with their sophisti tion," he says. "It's un-American!" Smith started at Superfu four years ago after graduating with a business degree fr New York University.

HOOPLA AND SALESMANSHIP

A CLOSED-DOOR SECTION OF THE financial industry t used to be characterized by confidential offering docume and intimate relationships with the hyperrich is morphing i a full-scale retail business with almost a carnival atmosphe hoopla and salesmanship. Third-party marketers have take blast e-mailing promotions about funds they barely know.

"You have to ve trust."

ANTHONY GORDON,
a New York photographer who s his Superfund stake has done although he doesn't know what it's invested in.



"He sounded so optimistic about hedging."

ASHOK KUKADIA,
describing his positive reaction to a Christian Baha radio interview; the urologist and his father-in-law, Biraja Paul, have both invested.

"I'm not so young at I can afford ose a lot of oney."

STEPHEN SCOTT,
a 54-year-old corn and wheat r in Burlington, Colo., who has 88,000 of his family portfolio invested in Superfund.

*2005 Center for Automotive Research study. Includes direct, dealer and supplier employees, and jobs created through their spending.
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Toyota U.S. Operations
Plants 10
Jobs 386,000*
Investment ..... $13 B

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TOYOTA
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nancial planner Lane Jones of Evensky & Katz in Coral Gables, Fla., says he gets up to 10 cold calls a day from people hawking alternative investments. He used to get four or five a year. Wood River Capital Management engaged several outside promoters to boast about its returns—which they did until only weeks before the Ketchum (Idaho) hedge fund collapsed last fall amid accusations of fraud and reckless investing.

Jason Okie of Snug Harbor Capital Advisors sent some of those e-mails but says he was "simply a conduit for Wood River's marketing material." It's investors' responsibility to investigate such claims, he adds. Lawsuits concerning Wood River are pending, and its principal, a previously unheralded stock analyst, denies fraud. But investors almost certainly will end up losing millions of dollars.

Regulators worry that relatively unsophisticated investors are betting on funds they don't understand. For several months, the NASD, a securities-industry self-regulatory group, has been looking into whether Merrill Lynch, UBS, Citigroup, and other major firms have improperly marketed hedge funds to individuals who don't meet the financial eligibility requirements. NASD officials won't discuss the particulars of their probe, but they do say that because of concerns about the aggressive marketing of hedge-fund-style products to retail investors, they have made this area a priority for 2006. NASD's enforcement chief, Barry R. Goldsmith, says he is especially concerned about the growth in funds where "a substantial portion of the investment is coming from investors who are purchasing at the minimums"—which may indicate an influx of smaller fry who can't afford the risks. (Merrill and UBS declined to comment. A spokesman for Citigroup's Smith Barney unit said: "We did get an inquiry, and we're providing the information.")

TENNIS WITH THE PRINCE

SUPERFUND'S BAHA ARGUES THAT the real risk comes from investing only in stocks and bonds, with no protection should markets go down. "The superrich are used to going long and short," he says, referring to bets that markets will rise and fall. "Why shouldn't everyone be able to make above-average returns in any market?"

That message resonates with Ashok Kukadia, a urologist who lives in the leafy Long Island (N.Y.) village of Manhasset. He dipped in three years ago after hearing an interview wi Baha on the radio. "He sounded so optimistic about hedging says Kukadia, 40, who automatically puts in $1,500 a month a ter having invested an initial $10,000 stake and persuaded h father-in-law to invest $10,000, too. Superfund's drop last ye was "a letdown," Kukadia says, but he's betting on a solid pa off down the road. So is Stephen Scott, a 54-year-old corn ar wheat farmer in Burlington, Colo., who has $88,000 in Supe fund. "We've never done hedge funds before," Scott says. B he notes that, figuratively speaking, "going to Vegas is nothi

Pumping the Brand

How Superfund promotes itself to small investors

GLITZY ADS

European ads feature sports greats like racing legend Niki Lauda, who even promotes Superfund to a classroom full of eager students. Regulatory hurdles prompted Baha to feature himself in U.S. ads.

SPORTS TEAMS

CEO Baha favors sponsorship of Formula One racing and soccer teams in Europe as ways to reach a global audience. In the U.S., he supports the American Ballet Theater and is looking at other options.

WORLD AWARDS

Superfund was primary sponsor of the Women's World Awards in Leipzig, Germany, in November, honoring the likes of **model Linda Evangelista and *Desperate Housewives* star Teri Hatcher (with Baha).**

INVESTMENT CENTERS

Walk-in centers, modeled on Charles Schwab, are cropping up around the world. **The office on Fifth Avenue in New York** features gleaming interiors, a tropical fish tank, and Superfund-branded giveaways.

ROAD SHOWS

Superfund holds seminar on how ordinary investors can make money in the futures markets. Baha says he plans to build a mobile investing center and send it around the country this year on an 18 wheel truck.

new" for family farmers dependent on the weather and fluc ating market prices. Even so, Superfund's rapid swings can unnerving, he admits. "I'm not so young that I can afford lose a lot of money."

Superfund's glassed-in headquarters in Monaco overlook Riviera principality's Formula One Grand Prix route. In ad tion to sponsoring a racing team, the firm is developing its o Formula One series—a great marketing vehicle, Baha says man with an earnest demeanor who favors finely tailored su and resembles the actor Gary Oldman, he moved to Mon seven years ago. He clearly enjoys the swanky feel of the pl and mentions that he has played tennis with Prince Albert, local monarch. Baha insists that before settling in Monaco, didn't know about its fame as a haven from income taxes. now has blood ties to the tiny enclave: A former girlfriend sides there with their 2-year-old son, Dorian.

Standing against a backdrop of enormous yachts in agate-blue marina nearby, Superfund's founder reflects o lifelong fascination with finance. During a boyhood holi near Hungary's Lake Balaton in the 1970s, a prepubesc Baha paid 100 shillings, about $10, to buy 100 tubs of Ti

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200605

Balm. He smuggled the pungent Oriental ointment across the Austrian border and sold the tubs for five shillings apiece to flea-market vendors in his native Vienna. "500% markup!" Baha brags. (Actually, 400%.) "Trading was always in my blood," he adds, perched next to a table displaying Superfund-branded cabernet sauvignon.

Baha grew up in a middle-class Vienna family. His father, an insurance executive, wanted him to work for a bank someday. But Baha says that the death of his mother when he was 13 made him crave independence and adventure. He loved the action on *Miami Vice*, a popular TV import in Austria in the 1980 At 15 he defied his father and enrolled in the Vienna police aca emy. Reality, however, didn't match television. After graduatin in 1987, Baha spent four years patrolling down-at-the-hee precincts populated by new immigrants. He found it boring.

While still a cop he enrolled part-time at the University of V enna, where he rekindled his fire for finance. The thrill of a ser inar featuring top bankers remains vivid. "My heart was bea ing hard," he says. Walter Krippner, who for a time worked t night shift with Baha at a Vienna jail, recalls that even then h

HEDGE FUNDS

Wanted: Fund Manager, No Experience Needed

Superfund's Christian Baha, a former policeman, has lots of company in the ranks of hedge managers with unconventional backgrounds. "The 'hotness' of this field certainly has attracted people whose pedigrees [suggest they are at] greater risk to fail than those who have, say, served a more typical apprenticeship at a large hedge fund," says Randy Shain. He's vice-president of First Advantage Corp., producer of the BackTrack Reports, which conducts background checks on fund managers. Over the past five years, Shain says, his staff has seen "an Olympic gold medalist, some former military folks, several ex-professional football players, and a professional arcade-game player."

The record of ex-Minnesota Viking Rick Fenney illustrates the worst-case scenario. A running back from 1987 to 1991, Fenney worked during the 1990s for Norwest Investment Services Inc. and then briefly for Merrill Lynch & Co. in a San Diego suburb. In 2001 he opened a hedge fund operated by Fenney-McLean Capital Group Inc. He ran the fund until 2004 but didn't stay within bounds. Last Dec. 20 he pleaded guilty to wire fraud in federal court in San Diego, admitting he stole up to $2.5 million from the fund. Fenney agreed to make restitution and faces up to 20 years in prison.

No one compiles thorough statistics on hedge managers' backgrounds, but observers say a small but growing number of newcomers have little or no experience in jobs where fund managers have usually learned the ropes. Timothy Sykes, a 24-year-old New Yorker, started his $3.2 million Cilantro Fund Partners LP before graduating from Tulane University in May, 2003. He began with $100,000 from his parents and $900,000 of his own money. Sykes says he amassed his share from successful day trading during high school and college, having started at age 17 with $12,415 saved from bar mitzvah gifts. Trading, he says, "is basically like a video game for me."

To spread the word about Cilantro's reported gains of 20.4% in 2004 and 23.7% in 2005, Sykes paid $12,000 to post the fund's marketing materials last year on hedgefund.net, a site for investors with a net worth of $1 million-plus. The site publishes data on 5,450 hedge funds and other alternative investments. So far, Sykes says, he has received investments of $100,000 or more from three funds that invest in hedge funds and eight wealthy individuals.

There have always been hedge fund managers with unlikely résumés. Alfred Winslow Jones, who started the first hedge fund in 1949, was a financial journalist. Now some "activist" hedge funds, which buy stakes in companies and agitate for change, have begun hiring people with experience in the industries they are targeting, says Maureen Brille, managing director of executive-search firm Gerson Group. Several physicians run hedge funds today, including Dr. Richard W. Bank, a former gynecologist who started First-Tier Biotechnology Partners LP in 1995 in Los Angeles.

The assets of an Atlanta-based hedge fund firm whose principals include two anesthesiologists, International Management Associates, were frozen on Feb. 17 after a group of current and former NFL players who are investors filed suit in a Georgia state court, alleging forgery and fraud. A lawyer for the Atlanta firm didn't return phone calls seeking comment.

Some newcomers are keeping their day jobs. Jes Santaularia, manager of hedge fund Parrot Trading Partners LLC, is also the CEO of Diversified Concepts, a real estate development firm in Sarasota, Fla., which derives roughly half of its revenue from self-storage units. About 15 years ago, Santaularia started investing the cash his business generates in highly leveraged Standard & Poor's 500-stock index futures, which allow investors to bet on the direction of the stock index. "I was looking for ways to make better-than-money-market returns," he says. In April, 2004, he launched Parrot with $500,000 from friends, family, and business partners. The fund claims profits of 8% from Apr. 13 to Dec. 31, 2004, and 16% for all of 2005. It now has $4 million under management.

–By Anne Tergesen

Unconventional Résumés

Increasingly, hedge fund managers are turning up with unusual backgrounds. Here are some examples:

MANAGER	FUND	EARLIER OCCUPATION
Rick Fenney*	Fenney-McLean Capital Group	NFL running back
Timothy Sykes	Cilantro Fund Partners	College student
Richard Bank	First-Tier Biotechnology Partners	Gynecologist
James Simons	Renaissance Technologies	Math professor
Jes Santaularia	Parrot Trading Partners	Real estate executive

*Pleaded guilty to wire fraud in December, admitting he stole up to $2.5 million from the fund

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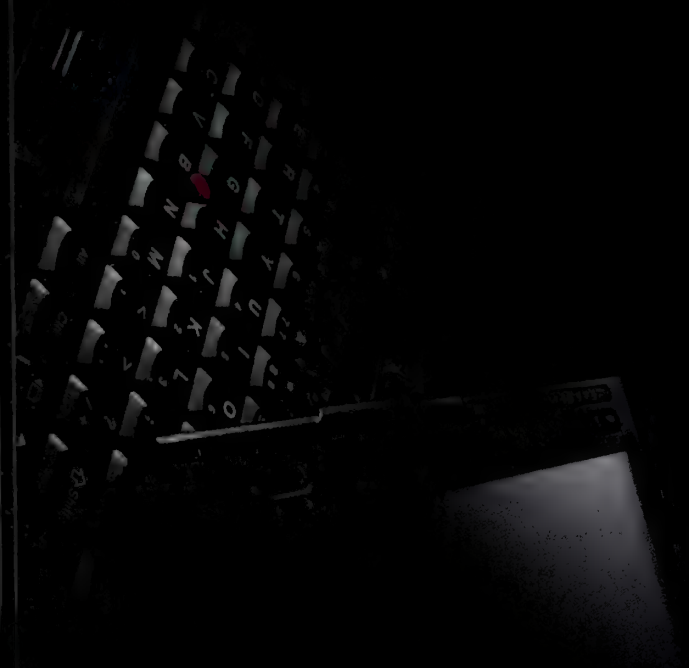

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friend expressed irritation that only the wealthy had access to exotic investments. "He would say: 'Why should only rich people be able to get richer?' "

Baha never finished his university degree. A former professor, Edwin Fischer, says his student was fascinated by computer programs for predicting market performance, "but he wasn't so interested in studying." In 1992, at the age of 24, Baha says he paid the equivalent of $5,000 for a tiny Vienna firm called Austria Broker Service, where he had moonlighted when not in uniform. He soon left law enforcement, and the brokerage became the seed that blossomed in 1996 into a fund company. He took on as a partner a quiet software designer named Christian Halper, who developed algorithms to predict trends in commodity-futures markets. Baha says he decided that with Halper's software he could devise "a way for people to make money under any conditions."

Speculating on commodities is one of the oldest and most volatile forms of investing. Whether it was Holland's famed frenzy over tulip bulbs in the 1630s or today's markets in pork bellies, currencies, or gold bullion, people often seek to profit from shifts in aggregate demand. The value of futures, which are contracts to buy something on a set date, doesn't necessarily move in sync with equity markets. Trading futures thus is one way to "hedge" bets on stock or bond prices.

Using Halper's algorithms, Baha says, Superfund invests in more than 100 markets based purely on past trends in prices, trading volume, and other factors. Like most practitioners of "technical analysis," though, Baha won't reveal his proprietary methods or which of those markets he's currently in.

Like other managed futures and hedge funds, Superfund tries to boost its returns by investing with lots of borrowed money. That allows it to buy contracts with face values that far exceed invested equity, magnifying potential profits—and losses. "These funds can go poof!" says New York financial co sultant E. Lee Hennessee. Last year was rough for a lot of hig ly regarded futures traders. One of them, John W. Henry, pri cipal owner of the Boston Red Sox, saw his 11 funds lose a tot of more than $300 million in 2005. Henry's firm called the r sults "an aberration."

"NO MORE HUMAN EMOTION"

WHEN BAHA AND HALPER launched their original fund nea ly 10 years ago, investors could buy a stake for as little $2,500. "We wanted something where we could invest ou selves," Baha says. The fund, then known as Quadriga, lost ov 10% its first year, which Baha blames on jangled nerves. Afte series of bad computer-driven bets on gold futures and oth markets, the duo pulled money off the table and missed a l upswing. By late 1997 their system was fully automated—" more human emotion," says Baha—and Quadriga reporte 21% return in 1997, followed by 63% the next year. Wooed minimum payments then set as low as roughly $100, more Au trian and German investors sent in checks. Banks in tho countries, initially hostile to Baha, eventually bought ir Quadriga. He branded the U.S. product Superfund and of cially renamed the whole company 2004 to avoid confusion with a Europe provider of digital service to hotels a other companies. (KPMG LLP says tha has audited Superfund's U.S. arm since start in 2002. Superfund says that KPM overseas affiliates have audited its funds Europe.)

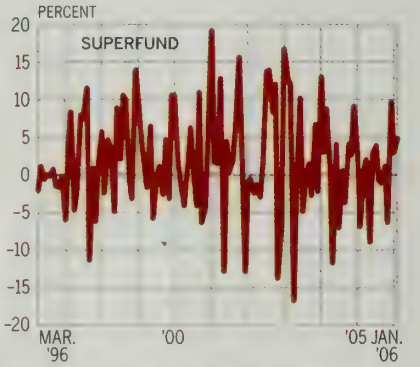
Baha and Superfund have receiv plentiful media coverage in Europe as result of promotional events seemin more suited to a beauty pageant or circ Last year he became the primary spon of the World Awards, initiated in 2001 Austrian author and Superfund public lations consultant Georg Kindel as a w to honor "men who exemplify the best tributes of mankind." Among the ecle honorees: Paul McCartney, the late N hunter Simon Wiesenthal, tyco Richard Branson and Ted Turner, and p singer Michael Jackson. Mikhail G bachev hosts the annual ceremony. In a mail interview, the former Soviet presid praises Superfund, noting that he "alw [tends] to support good ideas that a benefit to the average person and not o an additional privilege for the wealthy.

In November, Superfund sponsore Women's World Awards in Leipzig, G many. Winners included the designer natella Versace, former Pakistani Prime Minister Benazir B to, supermodel Linda Evangelista, and Alison Lapper, a Bri multimedia artist born with shortened legs and no arms.

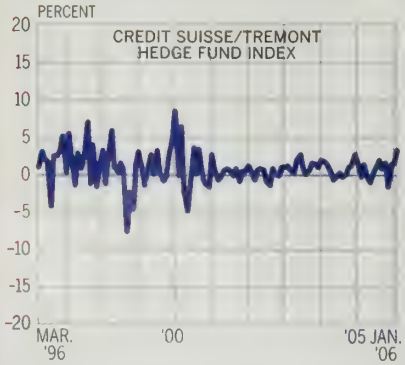
Now, Baha is trying to generate excitement in the U.S. Un in Europe, where he can boast in TV ads about Superfu 531% cumulative return over 10 years, U.S. securities reg tions permit him to mention only the product's name. (In p son, Superfund reps are happy to talk about the 35% and 5 cumulative returns in the A and B series of the U.S. fund si late 2002.) The very notion of advertising volatile investme

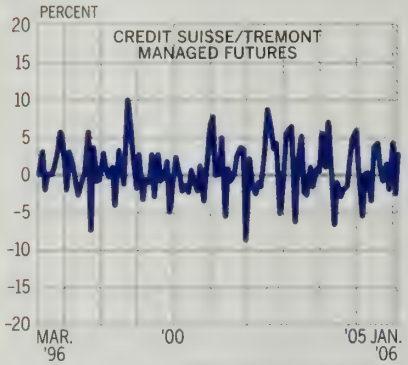
Super Performance

Reported returns for Superfund's main European fund have been strong*, though volatile



*A CUMULATIVE GAIN OF 531% SINCE MARCH, 1996





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on TV might still backfire if the spots remind veteran investors of the "Come Grow with Us" commercials in the 1980s featuring First Jersey Securities Inc. frontman Robert Brennan hopping out of his helicopter. First Jersey collapsed, and Brennan went to prison for fraud.

Frustrated that he has attracted only $110 million in U.S. investments, Baha held a brainstorming session recently at his Fifth Avenue retail center across from the main branch of the New York Public Library. He says he chose the location because it's on "one of the most important shopping roads in the world." But this stretch of the avenue is south of the chic stores; on its side of the street, Superfund's neighbors are an electronics discounter called On/Off Digital World and a T-Mobile outlet.

ADS AND IVY LEAGUERS

"TAKE OUT SOME PAPER, PLEASE!" Baha says sharply to Smith, his youthful U.S. manager, and four other tie-clad salesmen, all in their 20s and 30s. "What is the main reason we don't sell more in the U.S.?" Baha asks. Looking uncomfortable, the underlings begin to write. Smith, who is wearing Superfund cufflinks, notes that the market is saturated with investment products and that most ordinary investors don't understand what Superfund is selling. Baha agrees: "People think it's hocus-pocus or something." His remedies include buying more advertising and hiring from Ivy League universities. "The best guys want to go into hedge funds," Baha explains.

Investors need a lot of faith in Superfund's secret formula to jump on board. With all its management, sales, and incentive fees, clients in the less aggressive A fund need an 8.75% retu just to break even; the B fund has to earn 10.63% before i vestors see a profit. Such fee structures are not unheard of in t alternative-investing world. They are part of the reason Jo Valentine, a financial adviser in San Ramon, Calif., warns th Superfund "should never be a first, second, or even third inve ment." While Valentine has suggested that some wealthy clie allocate 18% to 22% of their portfolio to Superfund for diver fication, he would hate to see, say, an ordinary young couple t ing to build a nest egg bet big on the fund.

A couple of Valentin well-heeled clients have ready dropped out. One o jected that Superfund did directly hedge agai downturns in the equ market. Another didn't l that as its own broker-deal Superfund charges clie $16 or more for trades t might cost only $3 or $4 a discount brokerage. Baha sponds that his fees are si ilar to those of some riva adding that "discount b kers are not capable of h dling this business."

Then there's the issue Superfund's growing h Funds have a harder ti staying nimble and incogn in the markets when t near multibillion-dollar s tus. Even the motto—"Su fund: the Future of Inve ing"—might strike a flat n with some in the U.S. "It pretty arrogant nam Valentine chuckles.

To Baha, Superfund "s everything." And the t waste association? Not problem. Says Baha: "O so we clean up the market

Some Superfund loyalists wish the fund wasn't trolling small investors. Clarence Parsons, a retired Merrill Lynch b ker and multimillionaire who bought into Superfund al three years ago, would rather it restrict itself to customers him. "I wish they had a $100,000 minimum," says Pars who invested based on Superfund's European track rec Scott, the Colorado farmer, was briefly tempted last year to Superfund but is feeling calmer now that performance picked up. Even so, he wonders when the fund's comp model might, as he puts it, "go away."

Baha says that won't happen. Without disclosing any secr he says his program incorporates more historical data t those of his rivals and adapts to any conditions. Superfund l ly has received clearance to operate in the Netherlands, Swe and Dubai. It has products newly available in Japan, where vestors can get in for roughly $850. It's also the "first he fund to start operating in Poland," according to a spokes for the Polish Securities & Exchange Commission. Superfu says Baha, "will work forever." ■

–With Anne Tergesen in New York and bureau rep

BIO

Christian J. Baha

From Vienna policeman to alternative fund entrepreneur

TITLE Founder & CEO, Superfund

BORN Oct. 30, 1968, in Vienna to Helmut, an insurance executive, and Christine, who died of leukemia when he was 13.

EDUCATION Vienna police academy, two semesters of University of Vienna for international business administration (never graduated).

FAMILY Single; one son, Dorian, with ex-girlfriend.

HOME Monaco.

CHILDHOOD BUSINESS VENTURES Reselling Tiger Balm for profit; at age 8, taking bets from strangers on whether he could destroy a huge telephone book. (He could.)

EARLY JOB Policeman and jailer in Vienna

INVESTMENTS One-third in Superfund, one-third in gold coins or bars, and one-third in real estate, such as a house in Grenada, part of a tropical forest in Costa Rica, a cattle farm in Uruguay, and an organic farm in Romania.

LATEST BUSINESS VENTURE Opening health-oriented restaurants modeled on the cuisine of cultures noted for longevity: Japan's Okinawans, the Titicacas of Eastern Peru, and the Hunzas people in the Himalayas, who, he says, "live to be 120, 130 years old."

HOBBIES Jogging (lost more than 40 pounds a few years ago), skiing, tennis. Among his favorite books: *Hot Commodities* by Jim Rogers and *Forbes Greatest Business Stories of All Time* by Daniel Gross.

HEROES Michael Dell, Bill Gates, Michael Bloomberg, Sam Walton—"any founder who built something big."

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A Cancer Treatment You Can't Get Here

China, with lower regulatory hurdles, is racing to a lead in gene therapy

OUT IN FRONT SiBiono's Peng is raising production

BY BRUCE EINHORN

ONCE A WEEK, HAS mukh Patel, a 62-ye old retired semicondu tor engineer from Silic Valley, travels with wife, Bena, from th Beijing hotel to Beijin Haidian Hospital. They ride the crowd elevator to the ninth floor, enter a ple ant, sun-filled ward with private roo and Patel gets an injection that he ho will save his life. Suffering from late-st cancer of the esophagus, he has come Beijing for a Chinese gene-therapy d called Gendicine that's supposed to tumor cells.

Patel tried just about everything bef coming to China. He did three month traditional chemotherapy, flew to the hamas for treatment at an alterna healing center, and tried to find clin trials of experimental drugs. Noth panned out. By late 2005, his doctors that additional surgery or chemo co bring him only a few more months.

That wasn't good enough. "I'm not terested in buying time," says Patel, ting on a couch at Haidian and hold his wife's hand. He had heard ab Shenzhen SiBiono GeneTech Co., producer of Gendicine, which in 2003 came the world's first commercially a able gene-therapy drug. But the tr ment, which is approved and avail only in China, costs $20,000 per t month course and isn't covered by health insurance.

SETBACKS IN THE U.S.

PATEL IS ONE OF 70 foreign pati from 22 countries who have sought g therapy treatment at Haidian from D Dinggang in the past year and a hal the 50-year-old director of the C Therapy Center, is an oncologist spent five years as a research fello Johns Hopkins University in the 19 Since 1997, he has worked closely wit Peng Zhaohui, the chairman and chie ecutive of SiBiono, seeking to make C a leader in the field of gene therapy.

In the West, this experimental br of biomedicine suffered major setb following the death of one patient clinical trial in 1999. Other patients came down with cancer as a result of added genes, and the U.S. Food & I Administration halted a number of t

That created an portunity for Chi researchers. Withou same regulatory o cles, they were ab

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take ideas that originated in the U.S. but stagnated there. SiBiono's Gendicine, for instance, is similar to a gene therapy treatment that was pioneered by Introgen Therapeutics Inc. in Austin, Tex., but has yet to win approval from the FDA. As safety concerns forced the U.S. and Europe to apply the brakes, "China speeded up," Li says.

The Chinese are determined to keep the momentum going, and believe they can avoid the pitfalls that beset South Korea in stem cells. On Feb. 9, China's State Council announced a big boost in research and development spending to 2.5% of gross domestic product, from 1.3% now; biotech is a top priority. Li estimates that two dozen Chinese companies are developing gene-therapy drugs. "The Chinese are being very aggressive on this," says Dr. Jack A. Roth, chair of thoracic and cardiovascular surgery at the University of Texas M.D. Anderson Cancer Center in Houston. "They see a window of opportunity."

As a result, China has attracted not just American patients but also American researchers. James S. Norris, chair of microbiology and immunology at the Medical University of South Carolina, is president of the International Society for Cell & Gene Therapy of Cancer, which last December had a conference in Shenzhen, China. "If I were making a long-term investment in biotech, and particularly in gene therapy, I would be making it in China, not here," Norris says. "They have figured out how to get [gene therapy] approved." Norris is now trying to get funding to test his own promising gene therapy approach in China.

The father of gene therapy in China is SiBiono's Peng. Born in 1952 in the northern Chinese province of Shanxi, Peng has a joint PhD from a university in Xian and from Japan's Chiba University. Like Haidian's Li, he's a returnee from America, having worked at the medical school at the University of California at Los Angeles and at a biotech startup in San Diego in the mid-1990s. He launched SiBiono in 1998 with $300,000 in seed money from the Shenzhen government. Since then, SiBiono has received $5 million from private investors and more than $6 million in government grants.

Gendicine itself combines a gene named p53, which suppresses tumor formation, with a modified common virus. When the product is injected into a tumor, the virus carries the gene into cancer cells. The gene then prompts the tumor cells to commit suicide.

This basic approach was first developed by Introgen. The U.S. company's CEO and president, David G. Nance, believes that his patents cover SiBiono's treatment—a view Peng disputes. Both companies have gotten similar results in clinical trials. Used with radiation or other treatments, the added gene causes more tumor shrinkage than the older treatments used alone. It remains to be proven that the treatment extends life, however, even though some patients have lived longer than expected. Another problem: While the gene can be directly injected into tumors that doctors can see, more clever delivery methods are needed to get it into metastasized cancer cells.

Despite questions about the technology's ownership and effectiveness, Peng has big plans for the privately held SiBiono. Construction is under way on a $20 million facility on the outskirt Shenzhen that will be able to produce million doses of Gendicine a year, c pared with just 180,000 now. Peng the company is talking with foreig about potential partnerships. China logical place to work because more th million Chinese get cancer every Clinical trials are inexpensive, at al one-tenth the cost in the And the regulatory climat favorable. "The Chinese ernment is more open to in vation and new id compared to the fore counterparts such as the in America," says Peng.

China's Bet On Gene-Based Medicine

The giant is a relative newcomer in this field but brings important strengths to the table:

CLEAN ROOM A worker making Gendicine for SiBiono in Shenzhen

LOOSER REGULATION Chinese scientists say the country's regulators are diligent, but the system readily embraces novel treatments

TALENTED ENTREPRENEURS Many Chinese biotech companies are run by U.S.-trained doctors who have returned to China after working at American universities

A LARGE PATIENT POOL In the field of cancer alone, there are more than 2 million new cases diagnosed each year, so local companies have no trouble finding volunteers for drug trials

GOVERNMENT SUPPORT Seeking to build an "Innovation Economy," the Chinese government provides substantial funding and encouragement to local companies

"WE ARE ALL ANXIOUS"

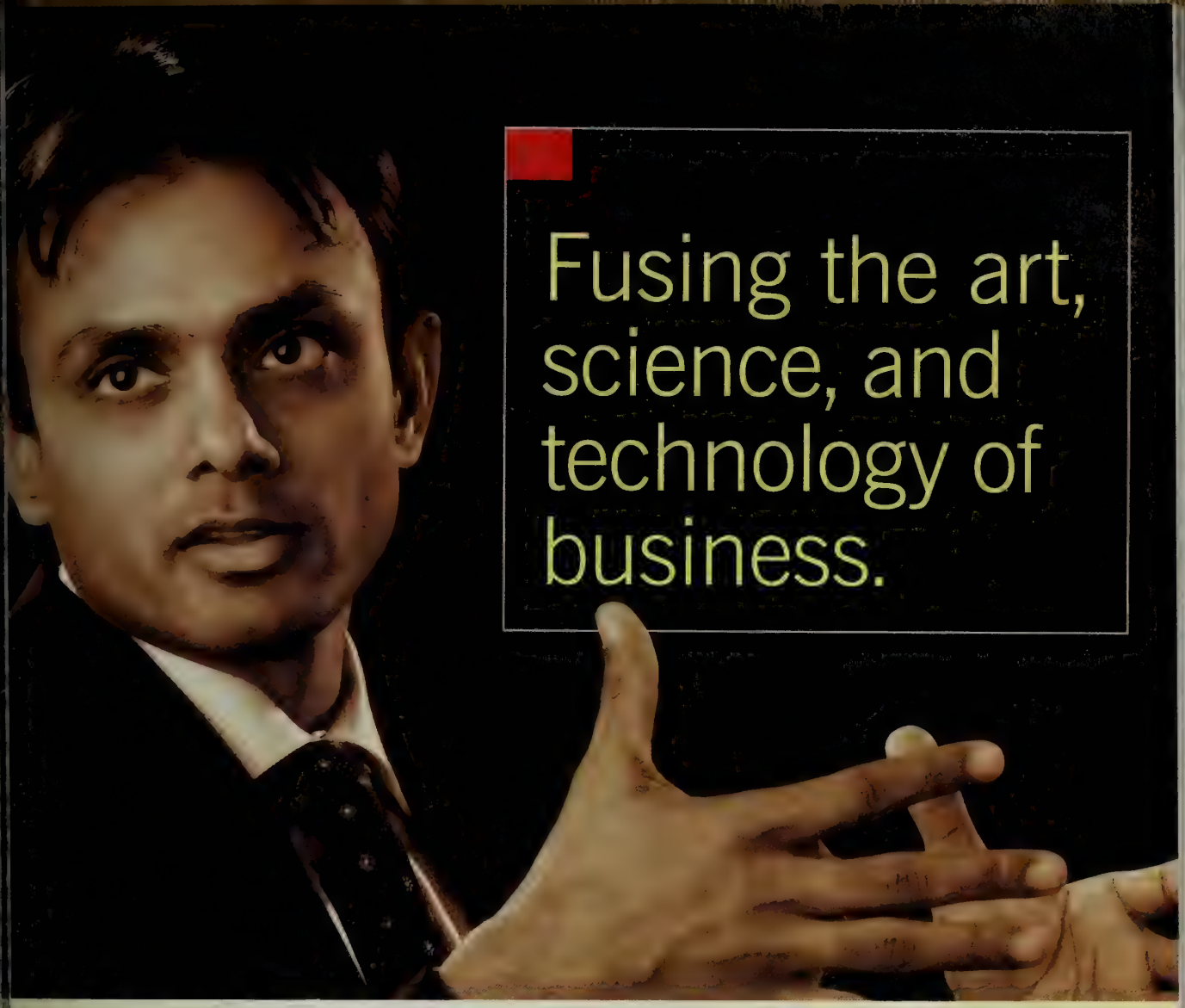
SOME PEOPLE wonder if nese regulators should required longer trials be approving Gendicine. "M they went into this premat ly," says Dr. Bauer E. Sun chief of vascular surger Yale University School of icine. "It is hard to believe would pass muster thro our own FDA." Adds T Ohnishi, a professor at Jap Nara Medical University: ter the [problems] linke gene therapy in the U.S. body wants to have anythi do with such treatments h

Even in China, not ever is sanguine. Cheng Jing, CEO of CapitalBio Cor state-backed biotech com in Beijing that is develo gene therapy. He fears that if Gend turns out to be ineffective, people wil faith in all gene therapy. He says th would feel more confident if there test results from independent do treating patients in the years sinc commercial launch. "We are all anxi says Cheng.

Doctors close to SiBiono insist tha na's first gene therapy drug is both and effective. Haidian's Li admits are risks, but argues that's true for al er cancer treatments. "Surgery is r he says. "Chemotherapy is risky. R therapy is risky." Gene therapy, he "can be used effectively to treat pati

And thousands of patients, like mukh Patel, are willing to tak chance. His decision to travel to was not hard, he says. "I didn't there was an alternative." ■

–With John Carey in Washi and Kenji Hall in



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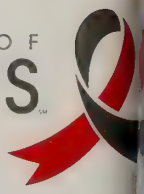

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NOVATIONS

batteries and ewing gum

uture hybrid cars may fit from more potent ries. MIT researchers unveiled a new lithium ry that can discharge echarge fast enough to ce the less power- ed nickel metal hydride ries used in today's ds. The invention should t in longer battery life, on odel of the lithium-ion ries now used in cell es and digital cameras. atteries should also be er to make and less rable to the explosion ems that have dogged nt lithium-ion power s. Reported in *Science* 17), the new recipe on a crystalline layering ium, nickel, manganese, xygen to speed up the f electrons to and from aterial.

r patients recovering colon surgery, chewing an help restore normal nction quickly, a recent suggests. Writing in ary's *Archives of ry*, scientists at Santa ra Cottage Hospital in rnia found that, of 34 ts who had undergone moval of a section of large intestine, 17 who chewed sugarless gum following surgery left the hospital in ys, 2.5 days sooner, on e, than the control Doctors suspect that hewing releases nes that activate the ve tract without ng recovering tissue.

COMPUTERS

FORGET THE MOUSE, WE'RE ALL HANDS

IN 1970, A PATENT was filed for an "X-Y position indicator for a display system." Neither the name nor the description—a wooden shell with two metal wheels—really captured the invention, the computer mouse, which is now ubiquitous and so simple that toddlers "get" it before they can talk.

Computer scientist Jeff Han and his team at New York University may have taken the next giant leap in user interfaces. Called "multi-touch interaction," it eliminates the mouse and keyboard and makes info displays much more intuitive. Han's team built a 36-by-27-inch flat screen whose pressure-sensitive surface can distinguish 10 or more fingers at once. It lets you pluck an object from deep inside a 3D space, pull it to the foreground, expand or shrink it, and merge it with other objects on the screen. You can call up a virtual keyboard, then brush it away when you're finished typing. The effect creates not a desktop but "an infinite landscape," says Han, who is in talks to commercialize the system. To see the prototype, Google "multi-touch interaction research."

RESEARCH

A NEW KEY TO FLESH-EATING DISEASE

VIRULENT STREPTOCOCCUS bacteria can quickly destroy large chunks of tissue in an infection dubbed "flesh-eating disease." Although rare—such infections occur in about 4 in 100,000 people—cases are increasing. The bug kills 20%-30% of its victims, even with antibiotics.

Why so deadly? Researchers at the University of California at San Diego have found at least part of the answer. Normally, the body is patrolled and protected by specialized immune system cells called neutrophils. These release nets made of DNA and other compounds that trap and kill invaders such as bacteria. But the flesh-eating streptococci have evolved a counterattack, the researchers discovered. The bacteria make an enzyme that dissolves the neutrophil's nets, allowing the bugs to escape the immune system. In mouse experiments, blocking this enzyme effectively treats the disease. *–John Carey*

PREVENTION

FILTERING OUT THE MADNESS BEFORE A TRANSFUSION

MAD COW DISEASE doesn't spread just when people eat tainted meat. Like similar brain-wasting diseases, it also can be transmitted via blood transfusions. Now, two outfits have invented filters that they say can make blood safe by screening out prions, the rogue proteins that cause such diseases.

A joint venture between Montreal's ProMetic Life Sciences and the American Red Cross has developed a resin imbued with chemical hooks that catch prions while

letting essential components of blood pass through. In tests led by Dr. Robert G. Rohwer, a neurologist at the University of Maryland in Baltimore, a group of hamsters remained infection-free after being exposed to prion-tainted blood that had been filtered. When control animals were exposed to unfiltered samples of the same blood, 14% became infected. France's MacoPharma hopes to sell the device in Britain, and Pall Corp. in East Hills, N.Y., wants to launch its own filter in Europe. *–Michael Arndt*

Follow My Money

A host of young bloggers have opened their finances for all to see—and learn from. **BY JESSI HEMPEL**

JONATHAN PING IS NOT A FINANCIAL GURU. He's not a certified financial planner. And he's not a millionaire (yet). He's simply a 27-year-old engineer living with his wife and dog in a rented house in Portland, Ore. Within the next 18 months he hopes to scrape up $100,000 for a down payment on a home, and he wants to build a net worth of $1 million by age 45. So far he's at $88,953. ¶ How do I know this? It's in bold type in the top right-hand corner of his Web log, MyMoneyBlog.com, where Ping keeps a daily tally of his progress. He's one of more than 150 bloggers, mostly 22 to 35, who have adopted an open-source approach to personal finance. Most keep their names secret, but that's about all they hide. In stark contrast to their parents' generation, for whom comparing incomes can be awkward, if not downright taboo, bloggers list financial information down to the dollar in retirement, brokerage, and savings accounts. They recommend investments, decry credit-card debt, and wallow together over high taxes, commenting on one another's postings and leaving behind a road map for financial voyeurs. Ping writes: "If I mess up, you'll know. If I come across a neat way to make or save money, you'll read about it here . . . hopefully we'll learn from each other and meet up in the Caymans some day."

I admit, I'm really into monetary voyeurism right now. I'm 30, and from what I hear, my generation is financially hamstrung. Books such as Tamara Draut's *Strapped* and Anya Kamenetz' *Generation Debt: Why Now is a Terrible Time to be Young* and articles like *BusinessWeek*'s "Thirty and Broke" (Special Report, Nov. 14) call attention to financial problems that plague us: sizable student loans, credit-card debt, a tight job market, and skyrocketing housing prices. Everyone from money doyenne Suze Orman (*The Money Book for the Young, Fabulous, & Broke*) to humorist Dave Barry (*Dave Barry's Money Secrets*) has weighed in. a growing number of young professio are bypassing pros in favor of Ping his merry band of bloggers.

It's an approach to financial advice appeals to a do-it-yourself genera steeped in content we have created selves. We enjoy reality TV as muc scripted dramas. We are as likely to w our friends' video clips as we are m videos. We trust bloggers as much as sometimes more than, journalists when it comes to financial advice, wh on experts when we can sift throug blogosphere to find folks roughly ou making roughly the same choice make and let them be our guides?

AT YOUR OWN RISK

MONEY BLOGGERS range from Chicago couple chronicling their clim of $98,615.39 in debt on Makelov debt.com to wealthy NYC Money, 26, posts about a $743k nest egg on money.iblogs.com. To be sure, the things wrong sometimes, and unlike t perts, they aren't required to disclose flicts of interest. But most put forth variation of the caveat offered by Ma X of myopenwallet.blogspot.com: "I take any of my advice, do so at your risk, as I am not really qualified to giv

Ping started MyMoneyBlog.com i cember, 2004. Having finished a ma in engineering at the University of Ca nia at Berkeley and taken an insu company job, he finally had more $500 in the bank. He first used the b ask advice about where to inves 401(k). Managing money became a dictive hobby. Over 14 months of posts he has amassed a readership th lies on his personal research about online savings accounts offer the bes motions (check out HSBC's fine prin 4.8% interest rate) and what credit offer the best incentives (Citi Profes MasterCard throws in a $100 gift ca

He has become an informal columnist as folks e-mail him scen like this: "I finally got a stable job. $9,000 in credit-card debt, half at 1 and half at 8.99% APR. I have no gency funds at all. Should I pay dow credit cards, or should I build a b money fund?" Ping often posts the tion along with his suggestions a vites readers to add their thoughts. 16 readers commented on this Feb. try, the consensus was that the in should get rid of high-interest debt

While Ping sticks to the nu

IN THIS SECTION:
Free range mutual funds
96 Six new picks for our Web portfolio
98 Antiques: Buying English oak
100 Little League gear, Big League prices

TAKE A LOOK Ping is letting the world watch his quest for $1 million by age 45

n blogger Jane Dough weaves more personal life into the chronicles on ongalsopenwallet.blogspot.com: king publicly about your personal es has always been a no-no in my y," Dough writes in a three-part es- acing her beliefs about money to a e-class childhood growing up as the est of five children of divorced par- A single woman of 35, n figures she needs 5,500 to provide her es what she'll need to n annually ($135,060, ing for inflation) in re- nt. She's at $366,111.12. rs enjoy her musings men and real estate, us online sales, and makes sense to give a 30 to shovel a snowy ay.

open-source money so allows you to avoid es by watching fellow rs make them. Take n, a 29-year-old IBM er in Raleigh, N.C., layed arbitrage with cash advances on credit cards offering 0% annual rates. He took out large sums on four cards and invested the money in high-yield savings accounts. His idea was to profit from the interest and return the cash when the 0% offers expired. He estimated he could make $700 off the interest over the course of a year. Good idea, until he discovered his credit score fell to 687 from 780, disqualifying him from the best mortgage rates.

After keeping tabs on these bloggers, you may want in on the game yourself. That's why a group of Web developers in Portland, Ore., recently launched Networthiq.com, a social networking Web site still in beta that is for money fanatics what MySpace has become for the music-obsessed. Users sign up and create profiles based on their net worth. They can then compare themselves with others by age, income, job, or geographic location, link to other users, and track their progress on a blog.

Meanwhile, what began as a hobby and a tool for Ping has become a profitable enterprise. He now makes more than $1,000 a month off the Google AdSense ads that bloggers can install for free, and he gets some income from referrals. Recently he picked up a $10 bonus for directing me to my new savings account with ING (with an interest rate of 4.75%). I got a $25 signing bonus for accepting his referral. I'll use it to buy him a drink when we all get to the Caymans.

Money Blogs

To find personal finance blogs that pique your interest, check out PFblogs.org, an aggregator site that pulls together posts and lists more than 150 blog URLs. Here are a few stand-outs:

PFBLOG.COM Daily posts, since 2003, by a blogger trying to save $1 million by 2016. He's at $426,753, up from $78,967.

MONEYBLOGNETWORK.COM Five bloggers who have banded together to offer one-stop reading.

MYOPENWALLET.BLOGSPOT.COM A mid-30s single New Yorker with a wicked sense of humor who lists her net worth as $256,348.

SAVVYSAVER.BLOGSPOT.COM A newly married 26-year-old Wisconsin blogger who is about to have a baby.

Funds That Play the Field

All-caps have their pick of equities, and are beating more focused peers. **BY LAUREN YOUNG**

FOR NEARLY TWO DEcades, equity mutual funds have been boxed in. That's because marketers have been packaging funds by investment styles such as small-cap value or large-cap growth at the behest of pension consultants and financial advisers who want to fine-tune their asset allocations.

Yet a small group of funds can pick and choose securities from all corners of the equity universe. Now these funds, which are called all-cap funds, are outperforming their style-specific peers and attracting attention from both individual and institutional investors. "People are looking outside the box," says Don Cassidy, senior research analyst at Lipper, the fund-tracking unit of Reuters.

The numbers are compelling. All-cap funds, also known as multicap or go-anywhere funds, beat their U.S. diversified-equity peers during the one-, three-, five-, and 10-year periods ending Jan. 31, 2006, according to Lipper. The outperformance is most dramatic in the 12 months ended on Jan. 31, when all-cap funds gained an annualized 16.9% vs. 14.4% for U.S. diversified-stock funds.

What gives all-caps the performance edge? Cassidy likens them to the sort of hedge funds that let managers run with their best ideas, "giving the portfolio manager a wider playing field," he says. That flexibility often results in steadier returns and lower volatility.

To find a good all-cap fund, check out *BusinessWeek's* Mutual Fund Scoreboard (bwnt.businessweek.com/mutual_fund/), which identifies more than 140 all-cap portfolios from a universe of more than 4,000 r tual funds. Using five-year performa data from Standard & Poor's, funds ranked by their risk-adjusted returns fr A (superior) through F (very poor). All- funds is a small fund category, so there only seven that are rated A (table).

All-Cap, All the Time

Managers of these funds don't confine themselves to a particular corner of the market, preferring to seek opportunities wherever they can find them. These seven funds are top-rated against all other all-cap funds in the *BusinessWeek* Mutual Fund Scoreboard. Ratings are based on risk-adjusted returns over the last five years.

FUND/SYMBOL	FIVE-YR. RETURN*	EXPENSE RATIO
Columbia Strategic Investor Z CSVFX	13.9%	0.99%
Fairholme FAIRX	14.3	1.00
Heartland Select Value HRSVX	13.0	1.33
Hodges HDPMX	14.5	1.68
Texas Capital Value & Growth TCVGX	19.5	1.68
Yacktman YACKX	14.1	0.95
Yacktman Focused YAFFX	14.0	1.25

*Appreciation plus reinvestment of dividends and capital gains before taxes through Jan. 31

Data: Standard & Poor's

DIVERSIFICATION TOOL

BECAUSE ALL-CAP managers can sl up and down the market-capitalizat spectrum, portfolios are often eclec Case in point: the A-rated Hodges Fu Holdings in the $365 million portfo which gained an annualized 14.5% in past five years, include lumbering gi such as General Motors as well as companies such as Life Time Fitnes small health-club chain. "One minute may be buying a small company in a ue situation. The next minute we are b ing Apple, which is a large-growth st that sells at a ridiculous multiple," Don Hodges, manager of the Da based fund.

That far-reaching, go-with-your approach is what appeals to Gary W chief executive of Webb Financial Gr a financial advisory firm in Blooming Minn., who started using the Ho Fund as a core holding for his clients year. "For smaller clients, it's a good versification tool, and for bigger clien put it in their portfolio strictly becaus a good fund," Webb says.

While all-cap fund managers have flexibility to buy all kinds of secur their portfolios are often concentra The A-rated Fairholme Fund only about 20 securities, including B shire Hathaway and EchoStar C munications. "There's a big ad tage in being able to go anyw and concentrate," says co-man Larry Pitkowsky. Indeed, the billion fund deftly rode out the market, thanks to a portfolio l with steady insurance stocks. with a 2% loss in 2002, its five annualized return is 14.3%.

At the A-rated Heartland S Value Fund, one of co-man David Fondrie's favorites is O Steel Mills, which makes stee railroad tracks and natural pipelines. Fondrie has held on stock even though it has almost bled since the fund bought it spring. All-cap managers can on to their winners, and are forced to sell when a stock the has moved outside of a design market range," Fondrie says. T lation: He's not boxed in. ■

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Net Stocks: Good Value Hunting

Our new list includes lower p-e stocks and pricey ones with hot prospects. **BY TIMOTHY J. MULLANEY**

JASON AVILIO, BY NATURE AND occupation, is bullish on the Internet. But in early January, Avilio wrote that Net stock prices were at worrisome heights. Even if fourth-quarter profits were good (they ended up about as good as expected), stocks might get hurt, he warned. Avilio says Net stocks are still priced as if companies will beat analyst expectations through 2006. And frankly, he is skeptical that they will.

Net stocks are nowhere as frothy as they were during the dot-com boom, but they're still pricey. That means any disappointment, especially from high-profile companies such as Google and Yahoo!, weighs heavily on the entire sector. At yearend, the BW Web 20, our portfolio of blue-chip Net companies, was up 30% since our last semi-annual revision in August. With the recent pullback Avilio foresaw, it's up just 11.5%. That's not bad: It beats the Stan & Poor's 500-stock index' 5% gain but trails the 12% for the AMEX Intera Week index Web composite.

As we visit the portfolio again, w keeping an extra-sharp eye out for va To make room for better-priced stocks, w dropping six. Audible, which sells do loads of audio books, and Amazon.con out because of their high price-earning tios (over 50 for Audible; 64 for Ama The Web real estate company ZipRe Chinese interactive-game company Sh Interactive, and online wireless-pl merchant InPhonic leave on weak e ings. Provide Commerce, an online fl falls out because it was just acquired.

Our hunt for lower p-e ratios prod four of six new picks, two from well-kn niches: online brokerage and adverti Stockbroker TD Ameritrade's merger TD Waterhouse could generate en growth to justify its 22 p-e: Merrill L analyst Harold Pinschmidt expects sa to begin by fiscal 2007, as manage tries to reprise its successful me with Datek Online Holdings. Digit the No. 2 online pure-play ad agenc hind Web 20 member aQuantive. Digitas trades at 21 times 2006 estim

business across borders

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ix New icks

eshuffling the inessWeek Web 20 del portfolio, we looking to replace losers with fast-wing companies more modest ations. For a plete list of the Web 20 ks, go to inessweek.com/extras

nding June 30, 2006. P-E for year ending 0, 2007 is 47.

ending Sept. 30, 2006

loomberg Financial Markets, sWeek

COMPANY/ SYMBOL	PRICE	P-E RATIO
BLACKBOARD BBBB Sells Web software that colleges use to manage course syllabuses, student accounts. Room to expand abroad, into U.S. high schools.	$28	37
DIGITAS DTAS Online ad agency's clients include American Express and General Motors. Now expanding to serve drug companies.	14	21
J2 GLOBAL COMM. JCOM Owner of the eFax service that converts faxes to e-mail. The company has proved resilient—and cheap.	42	17
VISTAPRINT LIMITED VPRT Online print shop and September IPO is the best new e-commerce play in the market. Pricey, but at a tipping point.	33	76*
TD AMERITRADE AMTD Online brokerage is consolidating, and its management has a strong track record of making acquisitions work.	20	22**
WEBSIDESTORY WSSI Companies like Best Buy and Bloomingdale's use its software to tell what makes Web customers buy.	14	25

ngs, about a third of aQuantive's p-e. o other entries are from more ob- parts of the New Economy. Web- tory makes software for e-merchants k what consumers do on their sites hat prompts them to buy. Jon Nord- chief executive officer of eBags, says this allows e-merchants to spend less on advertising. The stock trades at 25 times earnings. Cheaper yet is J2 Global Communications, whose eFax service converts faxes to e-mail for storage and record-keeping. CEO Scott Turrichi says J2 expects to make about $2.40 a share this year, and the stock goes for just 17 times earnings.

Even with our concern about valuations, we're willing to reach out to some pricier companies—Blackboard and VistaPrint—because of their excellent prospects. Blackboard's software lets colleges do everything from podcasting lectures to tracking prefunded student debit accounts so Junior can pay for coffee at an off-campus Starbucks with his school ID. With projected profit growth close to 25% a year, its p-e of 37 isn't out of line. VistaPrint has patented ways to batch thousands of small jobs and print them cheaply. Goldman Sachs analyst Anthony Noto says margins are expanding as VistaPrint grows. The rub is its stiff 76 p-e.

Web stocks could have a few tough months as the market reappraises how much to pay for growth. Even with our changes, the average p-e of Web 20 stocks is 38. That's still more than twice the p-e of the S&P 500. But with the Web economy growing about six times faster than the overall economy, it's a reasonable balance of risk and reward. ■

BusinessWeek weekend For more on investing in Net stocks, watch our weekly TV show, *BusinessWeek Weekend* (check local listings).

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If This Furniture Could Talk...

Collectors of 17th century English oak savor its history as well as its elaborate detail. BY STANLEY REED

IN 1988, BILL NESHEIM WAS antiquing in the Cotswold region west of London when he developed a passion for the richly carved, medieval-looking furniture made in the British Isles in the 17th century and earlier. Nesheim, who owns a wholesale jewelry business in Minnetonka, Minn., bought a three-legged chair made of spools that had been hand-turned on a lathe and two elaborately embellished coffers, or storage boxes. To his delight, his initials, B.N., were gouged into one of the boxes along with the date 1699. "I was taken by the beauty of the carving and the beautiful patina," says Nesheim. "I had never seen anything like them outside of books."

England has produced many distinguished genres of furniture. But to devotees, 400-year-old throne-like chairs, deeply worn stools, richly embellished cupboards, and other pieces fashioned from the wood of native forests, mainly oak, have far more charm than the more sophisticated items produced in the 18th and 19th centuries. Each piece is unique and handmade by craftsmen with tools that are little used today. "The great thing about oak is that it looks old," says John Andrews, author of *British Antique Furniture: Price Guide and Reasons for Values,* who has a small collection. "It is beautifully solid and well made. There is something about the style you can't help being attracted to."

You might think remnants from the time of Oliver Cromwell, Charles I, or Elizabeth I would be fearfully expensive. But while prices have risen sharply over the past two decades, the best pieces rarely approach the six- or seven-figure sums sometimes commanded by 18th century English furniture or early American antiques. A very desirable early 17th century livery cupboard or sideboard, for instance, sold for $38,000 at Christie's South Kensington showroom in March, 2005. Plain chairs and carved figures can still be had for a few hundred dollars. Christie's next London sale is on Feb. 28 (christies.com).

C. 1590 Carved on all sides, these supports probably were part of a bed

Americans don't have to cross the Atlantic to do their buying. Quite a few oak coffers, stools, and tables are circulating in the U.S., where they tend to be cheaper than in England because their prices haven't been inflated by the strong British pound. "We recently sold a lovely 17th century coffer with beautiful carving for $3,500. What else can you buy from that period for that price?" says Lisa Freeman, a dealer in Belmont, Vt. (fiskeandfreeman.com).

Sometimes you can get great deals in the U.S. because the sellers don't know the value of what they have. Trip Millikin, a New England financial adviser, snagged his favorite carved oak armchair, worth $7,000 to $8,000, at a New Hampshire auction for $800. "Most Americans think of oak as ugly brown furniture, and we like that just fine" because it dampens prices, he says.

Millikin and his wife Dora started collecting in the mid-1980s with the aim of acquiring one museum-quality piece a

C. 1650 Every element but the seat was turned on a lathe, and many of the bobbins spin freely

(L-R) PHOTOGRAPHS BY FISKE & FREEMAN (2); CHRISTIE'S IMAGES LTD. 2006

year. They disposed of a collection of 19th century American furniture to concentrate on English oak. One reason: They live on a farm, and oak can stand up to the rough life. In fact, old stains, burns, and the like tend to add to its appeal.

SILENT WITNESSES

MILLIKIN OFTEN wonders about the history of his collection. He talks of a 16th century stool whose feet show damage from spending centuries near a damp wall. He says he looks at the stool and marvels that it has been a silent witness to epochal events such as England's mid-17th century civil war. "If only that piece of furniture could talk," he says.

Old English furniture covers a wide range of items used by households and institutions such as churches. The most commonly found examples are coffers, which almost every early household used to store possessions. These range from plain planked boxes to elaborate affairs studded with relief carvings of flowers and human and mythical figures such as sea monsters. Also common are stools, the best examples of which can go for $10,000 or more.

Collectors not only study the objects themselves but also try to determine their social history. Wealthy merchants and the officers of medieval guilds showed off their importance by sitting in high-backed chairs with elaborate crests. The chairs weren't very comfortable, but they looked impressive. Big shots displayed their crockery on cupboards. Some of the earliest examples are just open shelves with carved decoration along the apron. In later pieces the shelves were enclosed, forming large cabinets called press cupboards. These items can be highly ornate, with elaborate carving and inlay work.

Simon Green, an oak specialist at Christie's in London, says dressers, which are long, low bureaus with drawers, are very popular, going for as much as $22,000. Other good sellers include richly carved beds, which can fetch $40,000 if they are in close to their original state rather than composites of new and old wood. Hanging wall cupboards also almost invariably fetch solid prices, and 16th century objects, which are relatively rare, command a premium over those from the 17th century. Not surprisingly, the English who emigrated to America in the 17th century continued to make similar furniture in the New World, but very early American pieces are rare and can fetch $100,000 or more.

While collecting English oak in the U.S. is possible, the mother country still has the deepest trove of stock. In addition to Christie's, Sotheby's and regional auction houses hold regular sales. England also boasts quite a few specialist dealers in oak and country furniture. Galleries William H. Stokes in Cirencester, Day Antiques in Tetford, and Beedham Antiques in Hungerford are all within a couple of hours' drive of London.

EARLY 17TH CENTURY CUPBOARD
Oak, fruitwood, and sycamore

Judging the value of English oak can be tricky without an expert's eye. Collectors closely examine carving quality and avoid pieces with major restoration. Good material usually shows centuries of wear, with the wood looking almost as if it had melted along the edges. Above all, experts prize patina and color—the result of hundreds of years of handling and polishing. "The best color is a rich and varied combination of black, chestnut-red, and golden brown," writes Victor Chinnery in *Oak Furniture: The British Tradition*, the bible of oak collecting. The surface should have a hard, glowing look. Oak is definitely an acquired taste. But once acquired, collectors say, it's hard to resist. ■

BusinessWeek online To view a slide show of English oak furniture from the 17th century and earlier, go to businessweek.com/extras

Deck Them Out For the Ball Game

Shopping for your Little Leaguer? Get ready for some Big League prices. BY MARK HYMAN

REMEMBER THE TERROR you felt as a child going to bat in a Little League game for the first time? Shopping for youth baseball equipment isn't quite that daunting. But if you don't know what you're doing, it's easy to swing and miss.

Back when we were Little Leaguers, baseball bats and fielder's gloves came in a few standard models, usually stacked in a dusty corner of the sporting-goods store. Now the array of colors, sizes, and product names far exceeds the pinstripes on Alex Rodriguez' Yankees uniform. Prices might surprise A-Rod, too. My 17-year-old son's latest acquisitions: an Easton Stealth bat ($280) and Rawlings' Pro Preferred catcher's mitt ($240). We're sharing the cost.

For younger children, prices don't run that high. Still, it pays to observe a few ground rules when searching for the next addition to your child's equipment bag:

BIGGER ISN'T ALWAYS BETTER. The most common mistake parents make is picking out a glove that's larger than their child can handle. "Parents feel the larger the glove, the more balls the child will catch. That's not the case," says Jeff Burton, merchandising vice-president at Baseball Express, an online equipment store based in San Antonio (baseballexpress.com). For small children, a large glove can be difficult to snap open and shut when a ball comes their way. Baseball Express shows you how to measure a glove (from the tip of the middle finger to the base of the palm) and match a player to the proper glove size by age and favorite position.

APPLY THE SAME THINKING TO BATS. Some parents lean toward buying longer, heavier bats than their child can easily handle. They reason that the kid player is less likely to outgrow this new possession in a year or two. Nice try. But that thinking won't be much comfort when Jane or Billy is struggling to swing. A six-year-old slugger should be using a bat 24 to 26 inches long. That one will be a good fit for the season ahead, not two or three down the road.

NICE CATCH A Nike Cal Ripken glove and an Easton Stealth bat

REVIEW THE LEAGUE'S EQUIPMENT RULES. How would you feel if you bought a $100 bat, then found out your child couldn't use it because it didn't fit the league's criteria? Many youth leagues have rules ering equipment. To learn the and don'ts, call your league p dent or visit the organization o Internet. At the Web site of I League Baseball (littleleague.o found a list of approved nonw bats—and model numbers— 16 manufacturers. In some lea parents are also asked to pro batting helmets. In our leagu Baltimore, a local ordinance quires that players wear hel outfitted with a horizontal, t bar protective cage. The kids g ble. But since the new helmet rived, we've had no reason t the dentist.

DON'T BUY THE HYPE. Since days on the diamond, y baseball equipment has gon scale. Nike's Cal Ripken s youth gloves, which cost feature "tumbled grain leather" th buttery soft. Bats as Rawlings' Pl and Louisville ger's Air Omah for $160 and For serious kid pl who crave top co tition, top-of-the equipment can b right choice. For mos dren, though, you can the fancy stuff. A $30 made of less durable le should suffice. As for bat latest models may smash with more power, but "99% ting is technique and an exp bat doesn't help with that," former big-leaguer Jason Th son, who runs a baseball sch kids in Rochester Hills, (jasonthompsonbaseball.com

DON'T SKIP THE TRYOUT. Rese afternoon so your child can out as many gloves and bats a sible. "Sometimes, a bat just good feeling in your hands," sa mer New York Yankees slugge Balboni, who runs a baseball in Edison, N.J. (stevebalboni.com).

As Little League season nears, forget the most important advic youth ballplayer of this or any g tion: Before you take your new glove to the ball field, remember an indelible marker and write name on it. ■

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EDITED BY MONICA GAGNIER

WATCHES

FINALLY, A LITTLE LUXE FOR LEFTIES

THE TIME HAS finally come for southpaws: **Cartier** recently began offering some of its most popular watches in leftie styles. On the new models the piece you use to set the watch—known as the crown—is on the left-hand side. While some smaller watchmakers such as **Panerai, Breitling,** and **Chronoswiss** offer left-handed models, jewelers say this is a first for a big luxury company. Cartier's models include the $4,900 Santos 100 in stainless steel (left) as well as the Cartier Pasha 42 in 18-karat yellow gold ($15,300). The limited-edition timepieces are available at Cartier stores in Beverly Hills and New York.

–Lauren Young

ADVICE

NEED A ROOFER? ASK ANGIE

EVER BEEN BURNED by a service contractor? Subscribers to angieslist.com can avoid that problem. The site rates roofers, home improvement people, mechanics, wedding planners, and even pet sitters in more than 30 cities from A to F on price, quality, responsiveness, punctuality, and professionalism.

Angie's List has been around in some areas for more than a decade, but it's rolling out to New York in March, followed by Detroit, Las Vegas, Orlando, Sacramento, and San Antonio later this spring. Subscriptions range from $4.95 to $5.95 a month, depending on your city, after a one-time sign-up fee of $10. And, yes, there really is an Angie: Angie Hicks helped found the site in 1995 by going door to door in Columbus, Ohio, to recruit members and collect reviews.

PENSIONS

Out of Deep Freeze

DESPITE A FEW HIGH-PROFILE COMPANIES such as **IBM** and **Hewlett-Packard** freezing some of their defined-benefit pension plans in recent months, this big chill may turn into an ice age. Stewart Lawrence, senior vice-president at benefits consulting firm Segal, says some employers may need to thaw out those programs in which existing employees no longer accrue benefits or new workers are totally shut out.

Pointing the way are defense nonprofit **Aerospace** and **SBC Communications** (now **AT&T**), which have spiffed up their pension plans, in part to help retain experienced workers. In October, Aerospace rolled out a hybrid plan that lets workers get half their benefits from the traditional plan, which had been frozen. In January, 2005, SBC beefed up its managers' defined-benefit plan to reward long-term employees. It was the second pension sweetener for the telecom, which froze the plan in 1997. As boomers retire and competition for workers heats up, Lawrence says companies may be compelled to offer defined-benefit plans again. "Employers," he predicts, "will view them as part of their talent-recruitment arsenal."

–Amy B

TIME OFF

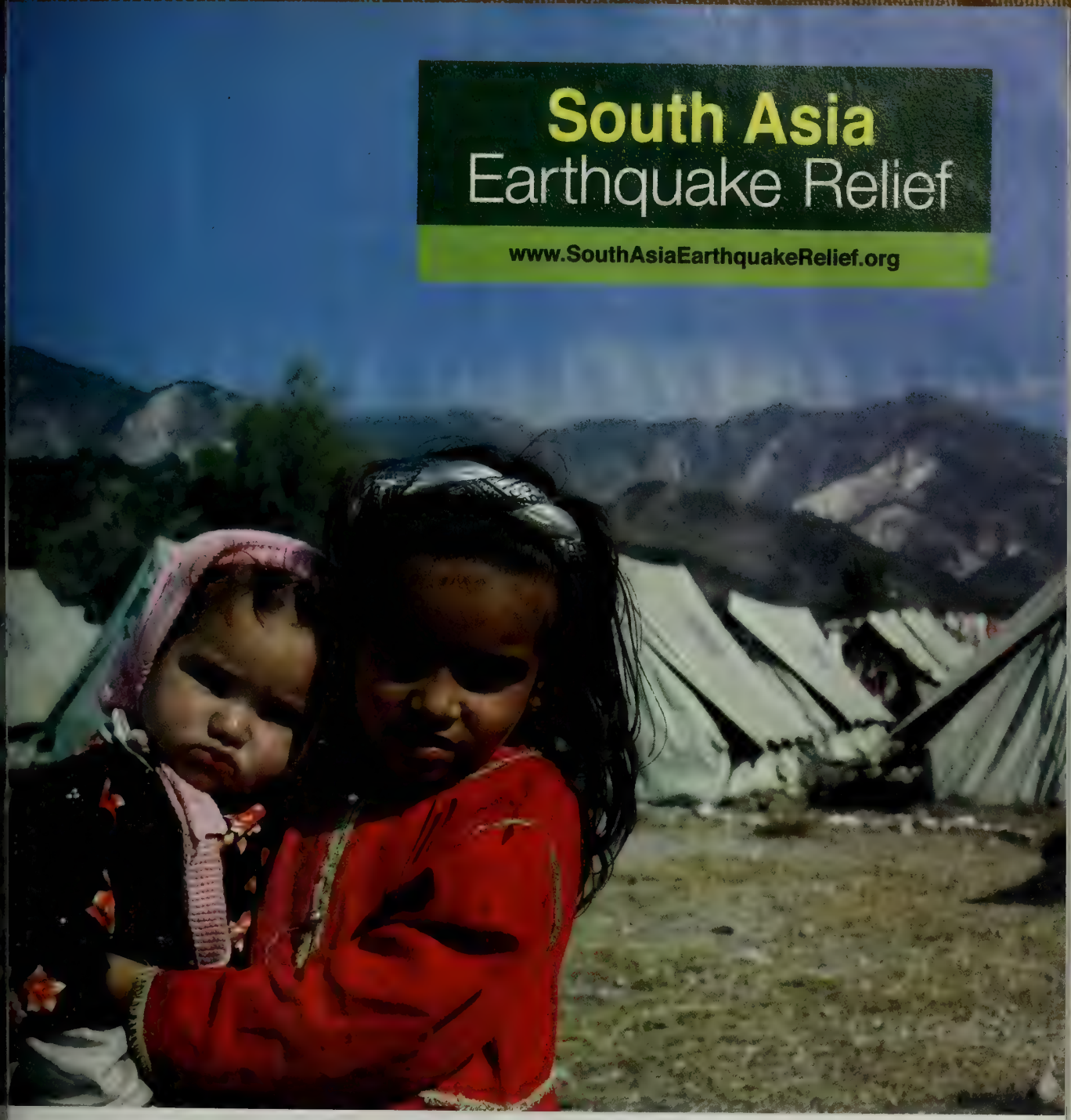
WITH BOXING LACKING star power these days, another contender has stepped into the ring. The Ultimate Fighting Championship, a mix of boxing, wrestling, and martial arts, has become a hot ticket in Las Vegas. League stars Tito Ortiz and Forrest Griffin will go glove-to-glove in a rare out-of-Vegas slugfest on Apr. 15 in Anaheim, Calif. But fans will have to get their kicks on pay per view since the event is sold out. Tickets for Vegas matches, which run throughout the year, can be purchased at ufc.com.

–Christopher Palmeri

ORTIZ (far right)

South Asia
Earthquake Relief

www.SouthAsiaEarthquakeRelief.org



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BY GENE G. MARCIAL

SETTLEMENT OF A LAWSUIT COULD BOOST RESEARCH IN MOTION

GLAXOSMITHKLINE HAS EIGHT NEW DRUGS IN LATE-STAGE TRIALS

A PILL FOR LOW TESTOSTERONE IS ON THE WAY FROM ZONAGEN.

RIM: Back from the Edge

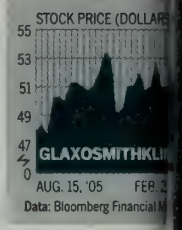
BREATHE EASIER, investors in Research In Motion (RIMM). Some Wall Street pros contend RIM is unlikely to be shutting down its BlackBerry operations. They're betting that RIM and challenger NTP, which in 2002 filed a patent-infringement lawsuit based on RIM's BlackBerry wireless device, will settle. RIM stock jumped from 68.35 on Feb. 13 to 73.14 on Feb. 22 on rumors that RIM and NTP might sign a deal before completion of the trial, which begins on Feb. 24. "We view a settlement as the most likely" of three scenarios, says Tavis McCourt of securities firm Morgan Keegan. Another possibility: The judge may delay a decision so it can review the U.S. Patent Office's action on Feb. 22 rejecting NTP's patent claims. The least likely scenario: RIM could launch a "workaround" technology to replace Blackberry. McCourt rates RIM "outperform," with a 12-month target of 90. Kenneth Leon of Standard & Poor's, who rates RIM a "buy," says the best result for both would be a settlement of, say, $500 million. He says RIM is attractive despite rivalry from Motorola and Nokia and potential risks from the lawsuit. RIM's growth could exceed 30% in 2007, he figures. Excluding litigation expenses, Leon expects RIM to earn $2.65 a share in 2006 and $3.50 in 2007, vs. 2005's $2.11. Goldman Sachs, which has done banking for RIM, calls the stock "attractive," noting that European subscriber growth was healthy in December and January. And pent-up demand in the U.S. continues to build, says Goldman, and will be probably "unlocked upon any resolution to the lawsuit."

BLACKBERRY Juicier

Why Glaxo Looks More Robust

BIG PHARMA, BESIEGED BY generic rivals, is hardly a Street favorite. But GlaxoSmithKline (GSK) may be an exception. Its top six products, including Advair for asthma and Coreg for cardiovascular disease, are seeing sales growth of 25% to 35% a year, and they account for 43% of total sales. Glaxo's stock, now at 50, is trading at historically low levels, along with its peers. "But Glaxo stands apart because of its above-average sales and earnings growth," says Kavita Thomas of First Global Securities, who rates it "moderate outperform." Devising new drugs is always a challenge, but Glaxo has eight in late-stage trials. Kevin Wilson of Citigroup, which has done banking for Glaxo, rates it a "buy" with a target of 58. Wilson, who owns shares, sees Glaxo earning $3.19 on its American depositary receipts in 2006 on sales of $40.9 billion, and $3.43 in 2007 on $42.5 billion.

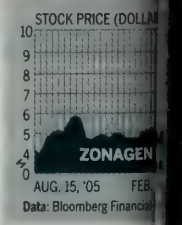
DRUG SYNERGY



Zonagen Is Feeling Its Oats

INVESTORS buying into tiny Zonagen (ZONA), whose shares have more than doubled since August, to 9.25, include some big players. As of December, 2005, UBS a 10% stake, and Efficacy Capital, which invests mainly in biotechs, owned 9.9%. Zonagen's chief product, Androxal one-a-day oral tablet for testosterone deficiency caused by condition called hypogonadism. Early results of a study o men showed that Androxal has the potential of restoring normal testosterone levels. CEO Joseph Podolski says a 20 patient Phase 3 clinical trial will be held later this year. Matthew Kaplan of Punk Ziegel, an investment firm, rates the stock a "buy, with a 12-month target of 14. "We're impressed with Androxal's efficacy," and an oral pill "is a clear advantage over the topically applied AndroGel," he says. Low testosterone afflicts 6.3 million men aged 50 to 80 in the U.S., he notes. Reduced sex hormone levels adversely affect muscle and fat mass, libido, mood, and cardiovascular health. Kaplan sees Androxal taking 4% of the U.S. market by 2010. Efficacy Capital's Mark Lappe says Zonagen remains "extremely undervalued," as it "addresses a $1 billion market." It's likely [that] the likes of Pfizer or Wyeth will Zonagen," he says. Another product, Proellex, for uterine fibroids in women, goes into Phase 3 trials this year.

DOUBLED SINCE AUGUS



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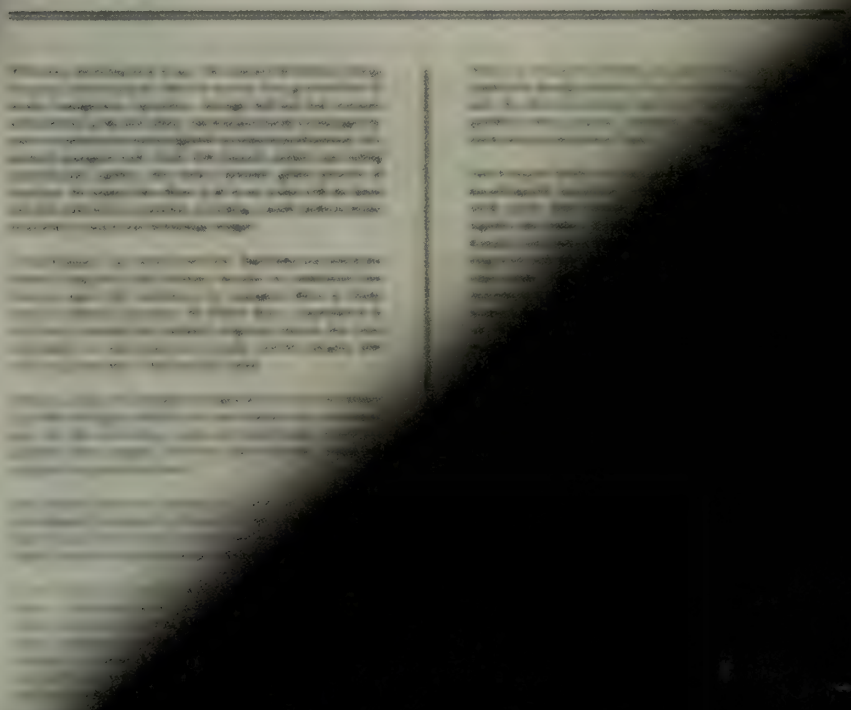

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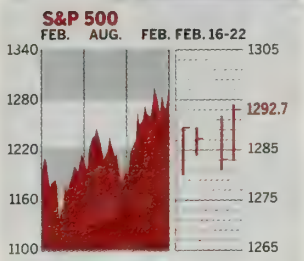
Personal Business Figures of the Week

STOCKS



COMMENTARY

The Dow Jones Industrials hit a new multiyear high on Feb. 22, rising on the wings of Boeing, which investors bet would benefit from strong foreign demand. AmEx and Caterpillar, Dow pillars, hit new highs, too. Tamer inflation news aided most stocks, although NASDAQ was weighed down by Dell, which cautioned on the next quarter. Oil prices were volatile, thanks to unrest in Nigeria.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	FEB. 22	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1292.7	1.0	3.6	9.2
Dow Jones Industrials	11,137.2	0.7	3.9	5.0
NASDAQ Composite	2283.2	0.3	3.5	12.5
S&P MidCap 400	779.4	1.5	5.6	19.8
S&P SmallCap 600	378.6	1.3	8.0	18.0
DJ Wilshire 5000	13,005.8	1.1	4.1	11.6

SECTORS

BusinessWeek 50*	762.1	1.0	2.7	7.6
BW Info Tech 100**	385.6	-0.1	1.3	8.5
S&P/BARRA Growth	611.1	0.7	2.5	7.3
S&P/BARRA Value	678.0	1.3	4.7	11.1
S&P Energy	395.6	2.7	6.1	19.8
S&P Financials	441.7	1.8	3.6	12.1
S&P REIT	168.9	3.0	10.4	25.5
S&P Transportation	264.3	0.0	5.8	18.8
S&P Utilities	164.5	2.5	3.1	15.2
GSTI Internet	196.2	0.3	-4.4	25.6
PSE Technology	874.8	0.3	4.6	18.4

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	FEB. 22	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1627.6	2.6	7.7
London (FT-SE 100)	5872.4	1.4	4.5
Paris (CAC 40)	5041.6	2.2	6.9
Frankfurt (DAX)	5862.1	1.7	8.4
Tokyo (NIKKEI 225)	15,781.8	-0.9	-2.0
Hong Kong (Hang Seng)	15,635.7	1.4	5.1
Toronto (S&P/TSX Composite)	11,800.2	2.1	4.7
Mexico City (IPC)	18,780.5	3.4	5.5

FUNDAMENTALS

	FEB. 21	WEEK AGO
S&P 500 Dividend Yield	1.78%	1.78%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.1	18.0
S&P 500 P/E Ratio (Next 12 mos.)*	15.0	14.9
First Call Earnings Revision*	-2.00%	-1.59%

*First C

TECHNICAL INDICATORS

	FEB. 21	WEEK AGO
S&P 500 200-day average	1228.9	1226.5
Stocks above 200-day average	66.0%	65.0%
Options: Put/call ratio	0.71	0.71
Insiders: Vickers NYSE Sell/buy ratio	4.34	4.05

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Steel	19.8	Oil & Gas Equipment	56.7
Constr. & Farm Mchnry.	15.5	Divsfd. Metals & Mining	53.0
Constr. Materials	15.4	Railroads	52.3
Intgrd. Telecmms. Svcs	13.3	Fertilizers & Ag. Chems.	51.3
Photographic Products	12.9	Oil & Gas Refining	51.3

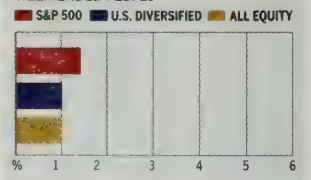
WORST-PERFORMING GROUPS

	LAST MONTH %	
Internet Retailers	-16.0	Automobiles
Tires & Rubber	-14.7	Home Entrtnmt. Software
Oil & Gas Refining	-11.3	Photographic Products
Oil & Gas Drilling	-10.4	Auto Parts & Equip.
Oil & Gas St. & Tr.	-8.1	Diversified Chemicals

MUTUAL FUNDS

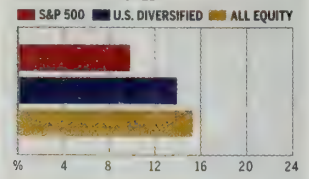
4-WEEK TOTAL RETURN

WEEK ENDED FEB. 21



52-WEEK TOTAL RETURN

WEEK ENDED FEB. 21



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Communications	4.5	Latin America	67.5
Latin America	3.1	Precious Metals	44.9
Real Estate	3.0	Diversified Emerg. Mkts.	41.2
Pacific/Asia ex-Japan	2.9	Natural Resources	36.2
LAGGARDS		LAGGARDS	
Japan	-4.4	Domestic Hybrid	7.9
Natural Resources	-3.8	Miscellaneous	10.0
Diversified Pacific/Asia	-1.3	Large-cap Blend	10.4
Utilities	-0.1	Large-cap Value	10.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFds. UltTelcmms. Inv.	16.5	ING Russia A	92.7
Janus Asp. Life Scncs. Srv.	9.9	ProFunds Ultra Japan Inv.	87.3
ProFds. Mble. Tlcmms. Inv.	9.8	T. Rowe Price Latin Am.	75.6
Dreyfus Prmr. Gr. China A	9.4	iShares MSCI Brazil Idx.	74.9
LAGGARDS		LAGGARDS	
Ameritor Investment	-14.3	Ameritor Investment	-66.7
Fidelity Japan Small Co.	-10.6	American Heritage Grth.	-42.9
Fidelity Sel. Enrgy. Serv.	-8.2	ProFds. USh. Sm. Cap Inv.	-29.1
Japan Smaller Cos.	-7.9	ProFds. USh. Mid Cap Inv.	-28.5

INTEREST RATES

KEY RATES

	FEB. 22	WEEK AGO
Money Market Funds	4.03%	4.01%
90-Day Treasury Bills	4.57	4.55
2-Year Treasury Notes	4.67	4.69
10-Year Treasury Notes	4.53	4.60
30-Year Treasury Bonds	4.48	4.57
30-Year Fixed Mortgage†	6.16	6.25

†BanxQu

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR.
General Obligations	3.83%	
Taxable Equivalent	5.47	
Insured Revenue Bonds	3.95	
Taxable Equivalent	5.64	

THE WEEK AHEAD

NEW HOME SALES *Monday, Feb. 27, 8:30 a.m. EST* » January new home sales most likely edged up to an annual rate of 1.28 million, from a pace of 1.27 million in December. That's the median forecast of economists polled by Action Economics.

GROSS DOMESTIC PRODUCT (REVISED) *Tuesday, Feb. 28, 8:30 a.m., EST* » The second look at fourth-quarter real gross domestic product is expected to be revised up to an annualized growth rate of 1.5%, from an initial 1.1%.

CONSUMER CONFIDENCE *Tuesday, Feb. 28, 10 a.m., EST* » The Conference Board's February consumer confidence index most likely moderated a little to 105, from 106.3 in January.

PERSONAL INCOME *Wednesday, Mar. 1, 8:30 a.m. EST* » January incomes are forecast to have grown 0.5%, after a 0.4% rise. Consumer spending probably rose 0.5%, following a 0.9% gain in December.

PURCHASING MANAGERS' INDEX *Wednesday, Mar. 1, 10 a.m. EST* » The Institute for Supply Management's February factory activity index probably improved to 55.8%, from 54.8% in January.

CONSTRUCTION SPENDING *Wednesday, Mar. 1, 10 a.m. EST* » In January, building outlays probably increased 0.8%, after growing 1% in December.

The *BusinessWeek* production climbed to 270.4 for the week Feb. 11, and stood 13.8% abo year-ago level. Before calcula the four-week moving averag index slipped to 270.9.

BusinessWeek on

For the BW50, more investm data, and the components of the production index visit www.businessweek.com/extras

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The Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

AccessIntellect **46**
Advanced Micro (AMD) **61**
Amazon.com (AMZN) **96**
American Century Investments **70**
American Express (AXP) **46**
American Real Estate Partners **36**
AOL (TWX) **26**
Apple (AAPL) **18, 61, 94**
aQuantive (AQNT) **96**
Archipelago (AX) **70**
AT&T (T) **102**
Audible (ADBL) **96**
Autodesk (ADSK) **66, 68**
AutoNation (AN) **38**
AV Birla Group **46**
AXA (AXA) **61**

B

Babson Capital **61**
Barclay Group **74**
Baseball Express **100**
Bay Bridge Fabricators **45**
Bear Stearns (BSC) **30**
BEA Systems (BEAS) **66**
Berkshire Hathaway (BRK) **94**
Blackboard (BBBB) **96**
BMW **26, 38**
Boston Consulting **50**
Boston Red Sox **74**
BP (BP) **30**
Breitling **102**

C

CapitalBio **88**
Caris **61**
Cars.com **26**
Cartier **102**
Cendant (CD) **22**
Charles Schwab (SCH) **74**
Christie's **98**
Chronoswiss **102**
Cilantro Fund **82**
Circuit City (CC) **50**
Cisco (CSCO) **66**
Citigroup (C) **46, 50, 61, 74, 92, 104**
CitiusTech **46**
Coca-Cola (KO) **110**
Comcast (CMCSA) **16**
Compass Minerals (CMP) **13**
ConocoPhillips (COP) **30**
Costco (COST) **58**
Countrywide Financial (CFC) **112**
CSX (CSX) **40**
Customer Growth Partners **50**

D

DaimlerChrysler (DCX) **18**
Datek Online (AMTD) **96**
Dell (DELL) **37, 61**
Deutsche Bank (DB) **74**
Digitas **96**
Diversified Concepts **82**
Dow Chemical (DOW) **45**
DP World **30, 40**
Drewry Shipping **40**

E

Easton **100**
eBags **96**
eBay (EBAY) **66**
EchoStar (DISH) **94**
Edmunds.com **26**
eFax **96**
Efficacy Capital **104**
Efficient Frontier **42**
EMC (EMC) **61**
Emirates **40**
Endesa (ELE) **30**
Enron **13**
E.ON (EON) **30**
Equilar **13**
European Marine Energy **32**
EVA Airways **14**
Evalueserve **46**
Evensky & Katz **74**
ExxonMobil (XOM) **30**

F

Fairholme Fund (FAIRX) **94**
Fenney-McLean Capital **82**
First Advantage **82**
First Global Securities **104**
FirstTier Biotechnology **82**
Ford (F) **26, 38**

G

Galileo (CD) **22**
GB Holdings **36**
GE (GE) **18, 46, 50**
Genpact **46**
Gerson Group **82**
GlaxoSmithKline (GSK) **104**
GM (GM) **18, 22, 26, 38, 94**
Goldman Sachs (GS) **50, 70, 96, 104**
Google (GOOG) **26, 42, 61, 92, 96**
Gristedes **32**
G2 SwitchWorks **22**

H

HBK Capital **104**
Heartland Select Value Fund (HRSVX) **94**
Hewlett-Packard (HPQ) **61, 102**
Hodges Fund (HDPMX) **94**
Home Depot (HD) **46, 50, 58**
Honda (HMC) **18, 26, 38**
Honeywell (HON) **46**
Hovnanian Enterprises (HOV) **112**
HSBC (HBC) **92**
Hughes Supply (HUG) **50**
Hyundai **48**

I

IBM (IBM) **30, 61, 92, 102**
Icahn Partners **36**
ING (ING) **92**
InPhonic (INPC) **96**
Institutional Shareholder Services **14, 36, 37**
Intel (INTC) **24, 61**
International Management **82**
Introgen Therapeutics (INGN) **88**

J

Jaguar Cars (F) **38**
J.D. Power (MHP) **38, 48**
Jefferies (JEF) **16**
JohnsonFamily Funds **74**
JPMorgan Chase (JPM) **30**
J2 Global (JCOM) **96**

K

KB Home (KBH) **112**
Keefe Bruyette & Woods **70**
Kmart (SHLD) **50**

L

Lazard (LAZ) **13**
Life Time Fitness (LTM) **94**
Lionsgate **16**
Lipper (RTRSY) **94**
Liquidnet **70**
Louisville Slugger **100**
Lowe's (LOW) **50, 58**

M

MacoPharma **91**
Match.com **18**
McDonald's (MCD) **37**
McKinsey **46**
Mellon Financial (MEL) **46**
Menard's **58**
Merck (MRK) **64**
Merrill Lynch (MER) **74, 82, 96**
Microsoft (MSFT) **24, 30, 42, 61**
Morgan Keegan **104**
Morgan Stanley (MS) **64**
Motorola (MOT) **104**
Murray Capital **18**
MySpace (NWS) **26, 92**

N

Nastec (NSTK) **13**
NEC (NIPNY) **24**
Needham **61**
Neoglyphics Media **22**
NexGen Capital **46**
Nicholas-Applegate (AZ) **61**
Nike (NKE) **100**
Nokia (NOK) **22, 104**
Norwest Investment **82**
NPD Group **61**
NYSE Group (NYX) **70**

O

Ocean Power Delivery **32**
Ocean Power Technologies **32**
Oracle (ORCL) **30**
OrbiMed Advisors **64**
Orbitz **22**
Oregon Steel Mills (OS) **94**

P

Pall (PLL) **91**
Panasonic (MC) **24**
P&O **30, 40**
Panerai **102**
Parrot Trading **82**
Pfizer (PFE) **64, 104**
Pipal Research **46**
Pixar Animation (PIXR) **42**
Planet Products **68**
ProMetic Life Sciences **91**
Provide Commerce (L) **96**
Proxy Governance **37**
PSA International **40**
Punk Ziegel **104**

Q

Quadriga **74**
Qwest (Q) **37**

R

RadioShack (RSH) **30**
Rawlings **100**
Red Hat (RHAT) **30**
Research In Motion (RIMM) **104**
Reuters (RTRSY) **94**
R.L. Polk **26**
Roche (RHHVF) **64**
Royal Dutch/Shell (RD) **30**
R2 Investments **36**
RWE **30**

S

Sabre (TSG) **22**
Sam's Club (WMT) **58**
Samsung **18, 48**
S&P (MHP) **27, 94, 96**
Sanford C. Bernstein **64**
Sears (SHLD) **22**
Segal **102**
SG Cowen (SCGLY) **64**
Shanda Interactive **96**
Sharp (SHCAY) **24**
Shenzhen SiBiono **88**
Sirius Satellite (SIRI) **30**
Snug Harbor Capital **74**
Solectron (SLR) **46**
Sony (SNE) **16, 24**
Sotheby's (BID) **98**
Sun (SUNW) **30, 66**
Superfund **74, 82**
Supervalu (SVU) **37**

T

Target (TGT) **58**
Tata Consultancy **46**
TD Ameritrade (AMT
Thomson Financial **27**
Time Warner (TWX) **30, 36**
Toll Brothers (TOL)
Toshiba (TOSBF) **24**
Toyota (TM) **38, 48**
TransWorks Informa **46**
Travel Guard **16**
True Value **50**

U

UBS (UBS) **27, 74,**
United Technologies **46**

V

Van der Moolen (VD
Verdant Power **32**
VistaPrint (VPRT)
Volterra Consulting
Volvo (F) **38**

W

Wachovia (WB) **46**
Wal-Mart (WMT) **18, 58**
Walt Disney (DIS)
Webb Financial **94**
WebSideStory (WS
Wells Fargo (WFC)
Wipro (WIT) **46**
WNS Global Servi
Worldspan **22**
Wyeth (WYE) **104**

X

XM Satellite (XMSR
XO Communicatio (XOCM) **36**

Y

Yahoo! (YHOO) **26**

Z

ZipRealty (ZIPR)
Zonagen (ZONA)

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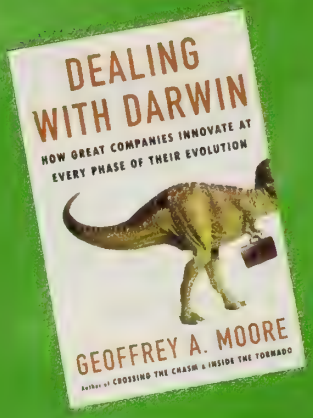

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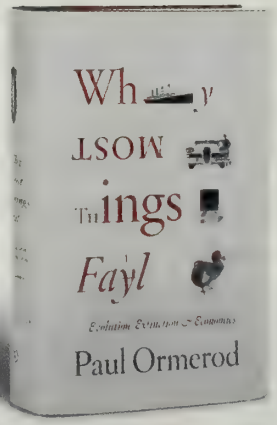
IdeasBooks

Failure Happens

WHY MOST THINGS FAIL Evolution, Extinction & Economics
By Paul Ormerod; Pantheon; 255pp; $24.95

Paul Ormerod, an unorthodox free-market economist in the tradition of Friedrich Hayek, made a surprising discovery a few years ago when he compared the failure rate of businesses with the extinction rate of species. In both cases, instead of an even flow, there were long stretches with few extinctions, interrupted by huge spikes in the failure rate.



Ormerod, a former British economic forecaster, noticed that these patterns didn't fit the well-behaved bell curve that economists are so fond of. In bell-curve economics, equilibrium is the norm. But he found that mass extinctions of companies and species are not all that unusual. Instead, the patterns fit what scientists call a power-law distribution, which is commonly observed in networks. (The Web follows a power-law distribution: The vast majority of sites have almost no links to them from other sites; a thriving handful attract thousands.) Ormerod and two collaborators published their results in *Physica A*, a journal of statistical physics.

Ormerod was stunned first by the spiky patterns and second by the strong resemblance between species and companies. Why should the patterns be the same, after all? Corporate executives constantly plan how to cope with the changing business environment. Plants and animals mostly don't plan at all. Yet a company is about as vulnerable to sudden death as, say, some zero-IQ South American fungus.

Why Most Things Fail is Ormerod's explanation of why failure is so common and apparently unavoidable, and what we can do about that unfortunate fact. He says the reason that companies are almost as likely to be blindsided as dodo birds is that the world is simply too complex and nonlinear for anyone to predict more than a short while ahead. What you can't predict, you can't avoid. And the reason that mass extinctions aren't so rare is that species, and companies, exist in networks analogous to the World Wide Web. The complex webs of relationships in networks—some competing, some cooperating—can breed chaotic outcomes. Both successes and failures tend to cascade. Winners take all, or most, and losers disappear in great bunches.

> Ormerod believes companies are as vulnerable as species

What does this mean for the average overstressed CEO? Ormerod is under no obligation to rescue executives from the dangerous world he has identified in this and two earlier works, *The Death of Economics* and *Butterfly Economics*. But he does try to be useful, as befits his day job as co-founder of a small but brainy business-consulting firm in London called Volterra Consulting Ltd. For government, he counsels restraint because most interventions in the workings of the market will just make matters worse. For business, he offers two bits of advice. First, keep trying to predict the future because, "Even a tiny bit of genuine knowledge goes a very long way." Second, keep experimenting because eventually something is bound to work. Here is how he ends the book

Marx famously wrote that the of capitalists was 'Accumulate, ulate, that is the law of Moses and phets!' As in many other s, Marx was completely wrong. te, innovate!'—that is the principle...."

ough *Why Most Things Fail* is no ement handbook, Ormerod has s and dislikes. Coca-Cola Co. ses him because it had the y to reintroduce the classic ation of Coke less than three after New Coke fell flat. ks Long-Term Capital ement, not just because the und failed in 1998 but because it failed. According to Ormerod, ead partners, including Nobel es Robert C. Merton and Myron , stuck to a misguided academic order, linearity, and equilibrium. The real world had other plans.

It's fascinating to compare Ormerod's book with another volume on failure, Jared Diamond's 2005 *Collapse: How Societies Choose to Fail or Succeed.* Diamond argues, contrary to Ormerod, that long-term planning is essential. But on closer inspection, his success stories don't illustrate much truly forward thinking. Example: Diamond shows that Japan under the shoguns staved off a deforestation disaster by curbing tree-cutting and beginning silviculture. But the shoguns' actions were more reactive than proactive. As Ormerod might say, even animals adjust when a resource they've depended on becomes scarce.

Although Ormerod waxes eloquent about the "iron law of failure," *Why Most Things Fail* mostly succeeds. Please don't hold that against his thesis.

—By Peter Coy

e BusinessWeek Best-Seller List

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IE WORLD IS FLAT Thomas L. Friedman arrar, Straus & Giroux • $27.50) *Globalization great—sort of.*

EAKONOMICS Steven D. Levitt, Stephen J. ubner (Morrow • $25.95) *Crack gangs, the Ku ux Klan, and more.*

INK Malcolm Gladwell (Little, Brown • 5.95) *Why snap judgments deserve careful nsideration.*

E NUMBER Lee Eisenberg (Free Press • $26) *neditation on retirement planning and the ation of a second act.*

E LITTLE BOOK THAT BEATS THE MARKET el Greenblatt (Wiley • $19.95) *A hedge fund nager's "magic formula."*

M CRAMER'S REAL MONEY James J. Cramer mon & Schuster • $26) *The CNBC mmentator's trading tips.*

E LITTLE RED BOOK OF SELLING Jeffrey omer (Bard Press • $19.95) *A syndicated umnist explains why people buy.*

LLAPSE Jared Diamond (Viking • $29.95) *y civilizations fall apart.*

E TOTAL MONEY MAKEOVER Dave Ramsey omas Nelson • $24.99) *Getting rid of debt d building reserves.*

NNING Jack Welch with Suzy Welch rperBusiness • $27.95) *How to succeed nin a company and against the competition.*

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1. **GETTING THINGS DONE** David Allen (Penguin • $15) *Organizing your office and managing your time.*
2. **THE AUTOMATIC MILLIONAIRE** David Bach (Broadway • $12.95) *How to put your investment program on autopilot.*
3. **J.K. LASSER'S YOUR INCOME TAX 2006** The J.K. Lasser Institute (Wiley • $16.95) *Sharpen your pencils, and...*
4. **THE ERNST & YOUNG TAX GUIDE 2006** Ernst & Young, LLP (CDS Books • $16.95) *...get out the calculator.*
5. **WHAT COLOR IS YOUR PARACHUTE?** Richard Nelson Bolles (Ten Speed Press • $17.95) *The 2006 edition of the enduring job-search bible.*
6. **CONSPIRACY OF FOOLS** Kurt Eichenwald (Broadway • $16.95) *Inside Enron's crumbling house of cards.*
7. **THE WALL STREET JOURNAL COMPLETE MONEY & INVESTING GUIDEBOOK** Dave Kansas (Three Rivers • $14.95) *Finance, etc.*
8. **THE 250 JOB INTERVIEW QUESTIONS YOU'LL MOST LIKELY BE ASKED** Peter Veruki (Adams • $9.95) *Don't forget to wear a suit.*
9. **THE TOTAL MONEY MAKEOVER WORKBOOK** Dave Ramsey (Thomas Nelson • $17.99) *A plan to remedy your money concerns.*
10. **THE 8TH HABIT** Stephen R. Covey (Free Press • $15) *Leadership in the new workplace.*

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IdeasFaceTime
WITH MARIA BARTIROMO

Jitters on the Home Front

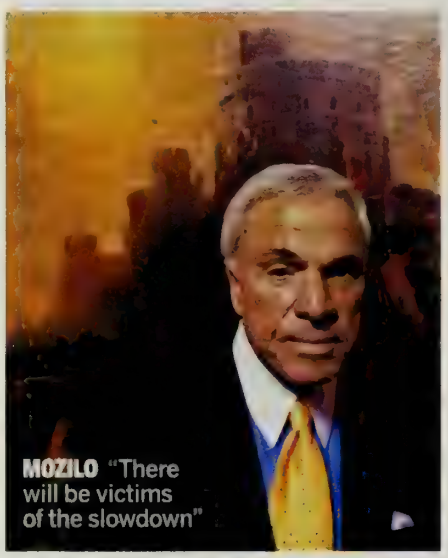
RECENT WEEKS HAVE knocked a lot of the exuberance—irrational or otherwise—out of the housing market. Homebuilders KB Home and Toll Brothers reported an increase in order cancellations and a decline in net orders for new homes. And Hovnanian Enterprises said it sees a softening in the pace of home sales and in price increases in some markets. I caught up with three housing heavyweights—CEO Angelo Mozilo of mortgage lender Countrywide Financial, CEO Bruce Karatz of KB Home, and real estate bear Professor Bob Shiller of Yale University—and asked how worried we should be.

How would you characterize the housing market right now?

MOZILO: The market has turned. The psychology of the buyers for single-family homes has clearly changed. We are seeing it from the flow of loan applications. If I had to pick a time, I would have to say it turned in January.

SHILLER: The real question is: Will it be a soft landing, or will prices come down substantially? It's hard to say because this is the biggest housing boom that this nation has ever seen, so we are in uncharted territory. I worry about a big fall because prices today are being supported by a speculative fever.... Home buyers typically expect price appreciation of 10% [a year] for the next few years, and that is not realistic. But I have learned humility when forecasting. Remember, we've had drops that looked similar before, notably at the end of 2003.

KARATZ: [The slowdown] started for us in our first quarter [beginning Dec. 1]. I think we will see the market settle off of its highs but still remain at very historically healthy rates two or three months from now. And with interest rates still attractive and the economy still chugging along, I think we will see housing come through very well. I would simply say that there is no indication that we should dramatize the present condition of the housing market.



MOZILO "There will be victims of the slowdown"

How severe are the price declines you are expecting?

MOZILO: I would expect a general decline of 5% to 10% throu out the country, some areas 20%. And in areas where you had heavy speculation, you could have 30%. We will see... ers back off from the prices they have been demanding. A or a year and half from now, you will have seen a slow dete ration of home values and a substantial deterioration in t areas where there has been speculative excess.

SHILLER: In Los Angeles in the last cycle, prices peaked in and bottomed out in 1997. In that interval, L.A. lost 40% real value. I can see that happening there again or in any o cities that have had tremendous price increases, and there quite a number of them in this country. I think a pullback much as 40% is plausible in many pl

KARATZ: I don't see a fundamental down other than in the hottest mar Things don't continue through the forever. This is a breather in prices that takes some steam out of the ma In some markets, 10% to 15% of b were speculators. You take them out the market drops 10% to 15%, and it three to four months for whatever hang there was to be sold, and the market stabilizes. That's where I thin will be three to four months from no

Where are the most vulnerable areas?

MOZILO: Miami and Fort Lauderdale Vegas is another area where the heavy speculation. That means p were buying three, four, five condo time and thinking they can flip t Those are the spots we have iden where... we will only make loans when we know the pe will live [in the housing].

SHILLER: The most spectacular cases are Phoenix and Las V They soared so suddenly. But others [are vulnerable, too,] su San Francisco, San Diego, L.A.—really much of California.

Will your earnings be hurt?

MOZILO: What we have to do is gain market share in order t even with last year. I have not been acquisitive. But give size we are now, the largest in the world, it's hard to gro ganically. There will be victims of the slowdown. And then be fallout, and we will survey the field and see if we can ac things on an opportunistic basis. ■

Maria Bartiromo is the host of CNBC's Closing Bell.

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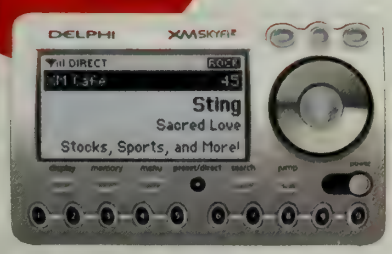

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IdeasOutside Shot

BY WARREN BENNIS

Lessons from Larry

It would be a huge mistake to believe that the main reason for Harvard University President Larry Summers' downfall was Larry Summers. Nobody would question that he had his faults—big ones, especially for a university president. His inability to subordinate his ego to the talents of others didn't help, nor did he seem to have the patience to develop and build coalitions that would support his noble and important educational goals, like improving undergraduate education, placing greater emphasis on math and the life sciences, and increasing direct faculty-student contacts. Summers had a great vision for Harvard that would likely have allowed it to thrive in a changing world. But what he never quite got is that leaders—especially those who are change agents—can only succeed when they have a reservoir of goodwill that allows them to convince followers that their fates are correlated.

Yet it wasn't Larry Summers' shortcomings that were at the center of his downfall. Some far more fundamental issues (pretty much obscured by the public's obsessive fascination with Summers' personality) were at work. And although these factors were just surfacing 35 years ago when I presided over the University of Cincinnati, I fear they will undermine future relationships between college presidents and all their stakeholders, especially faculty and students.

First, running a major research university today is far more complex and demanding than running any large, global corporation. And make no mistake, that's what Harvard or USC or NYU are: huge, global operations with bad parking. But there is no institution more vulnerable to, and hence more dependent on, external forces than the American university. One major reason is that such schools are not self-supporting. Tuition pays only a small percentage of the costs of running a university; most of the rest comes from alumni, foundations, sponsored research, or, in some cases, the state. The lulling image of the university as a bucolic outpost of learning both removed and somewhat "above" the outside society that nourishes it is not only outdated but, if believed and acted on, will actually bring about the university's decline or destruction.

Even worse, university leaders possess far less power than any CEO I know. While campuses aren't exactly parliamentary democracies, they do have often-strident faculties—with tenure—who have a redoubtable habit of speaking out and up. They are also often extraordinarily talented, self-absorbed "abdicrats" who don't want to lead—and don't want to be led. The Harvard faculty prayer, it is said, goes like this: "Dear Lord, deliver us from the heinous sin of intellectual arrogance . . . which for your information, means . . ."

One analyst even likened the job of university president to that of a pro hockey referee, and he's not far off the mark. The work is rough, physically exhausting, even dangerous. Presidents may lose fewer teeth than hockey officials, but they still have a startling number of stress-related problems. In the old days, skeptics like Thorstein Veblen referred to university administrators as "Captains of Erudition." Today a more fitting title would be "Captives of Constituencies."

So, unlike autocratic CEOs of yore, the would-be Larry Summerses of today's academic world face the near-impossible task of forming and managing coalitions. That's no easy feat when you consider the often warring factions within indvidiual constituencies. Indeed, the primary supporters of Summers were the students (only 19% were in favor of his resignation) and most of the faculty associated with the life and natural sciences. Meanwhile, with some important exceptions, the faculty most opposed to Summers and who initiated the votes of "no confidence" that eroded his leadership, are associated with the softer sciences (like sociology and gender studies) and the humanities. That's understandable since both undergraduate and graduate students, especially PhDs, can't find jobs in those disciplines. (As they say in Washington, "Follow the money.") And if dollars are flowing in to support jobs, fellowships or post-docs in your discipline, you're less likely to support the administrators that are holding the purse strings. And that's a conflict that's present at all major research universities.

> At Harvard, Summers possessed far less power than any CEO in America

That's why I hope Larry Summers' resignation will create an unintended legacy: an understanding of the systemic forces that could undermine all of our institutions of higher learning.

Warren Bennis, *chairman of the Leadership Institute at the University of Southern California, is also chair of the advisory board of Harvard's Center for Public Leadership and a former professor at Harvard Business School.*

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6 March 13

(P.62) | CHEAPER, FA

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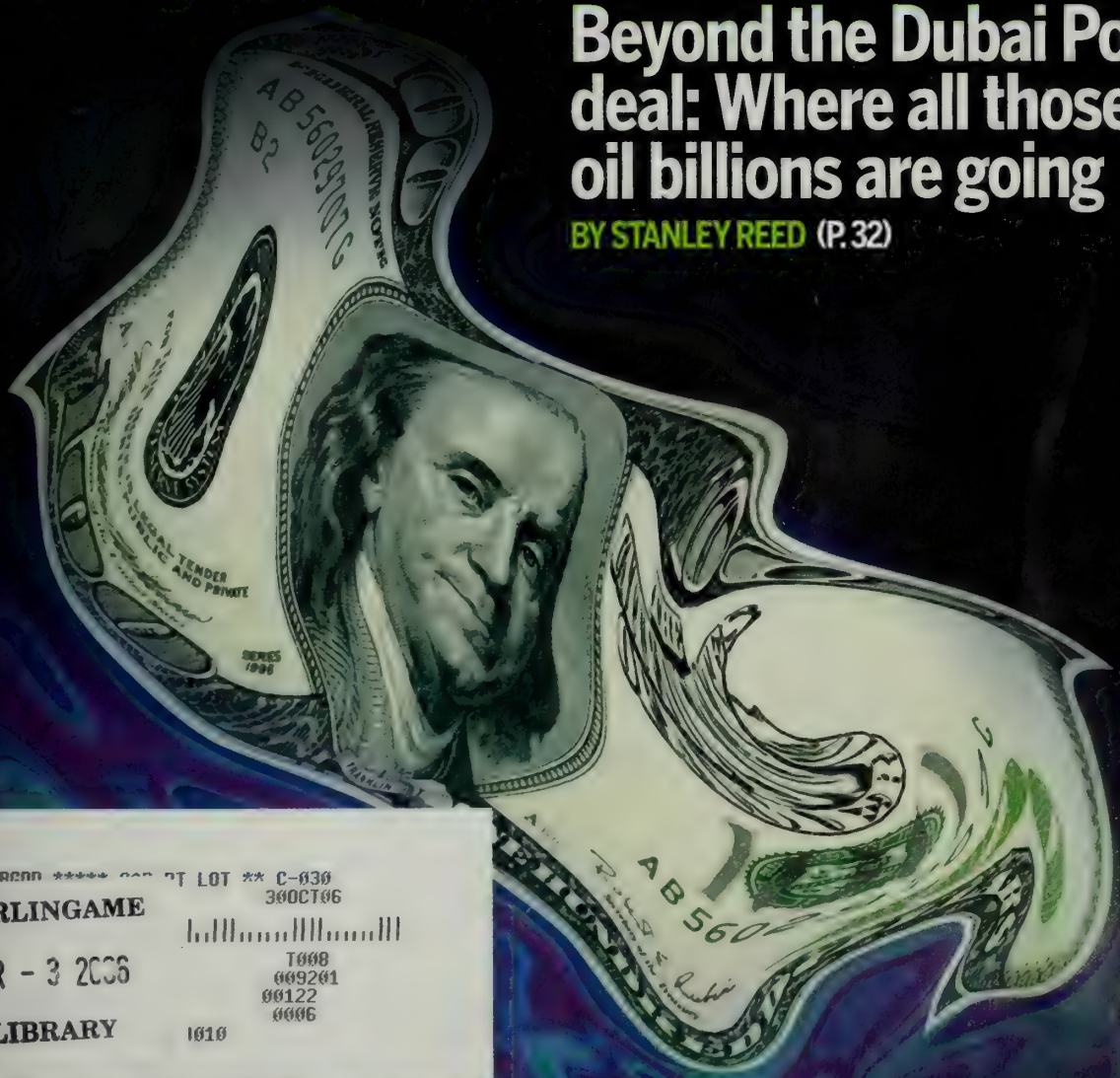
The NEW Middle East Oil Bonanza

Beyond the Dubai Ports deal: Where all those oil billions are going

BY STANLEY REED (P.32)



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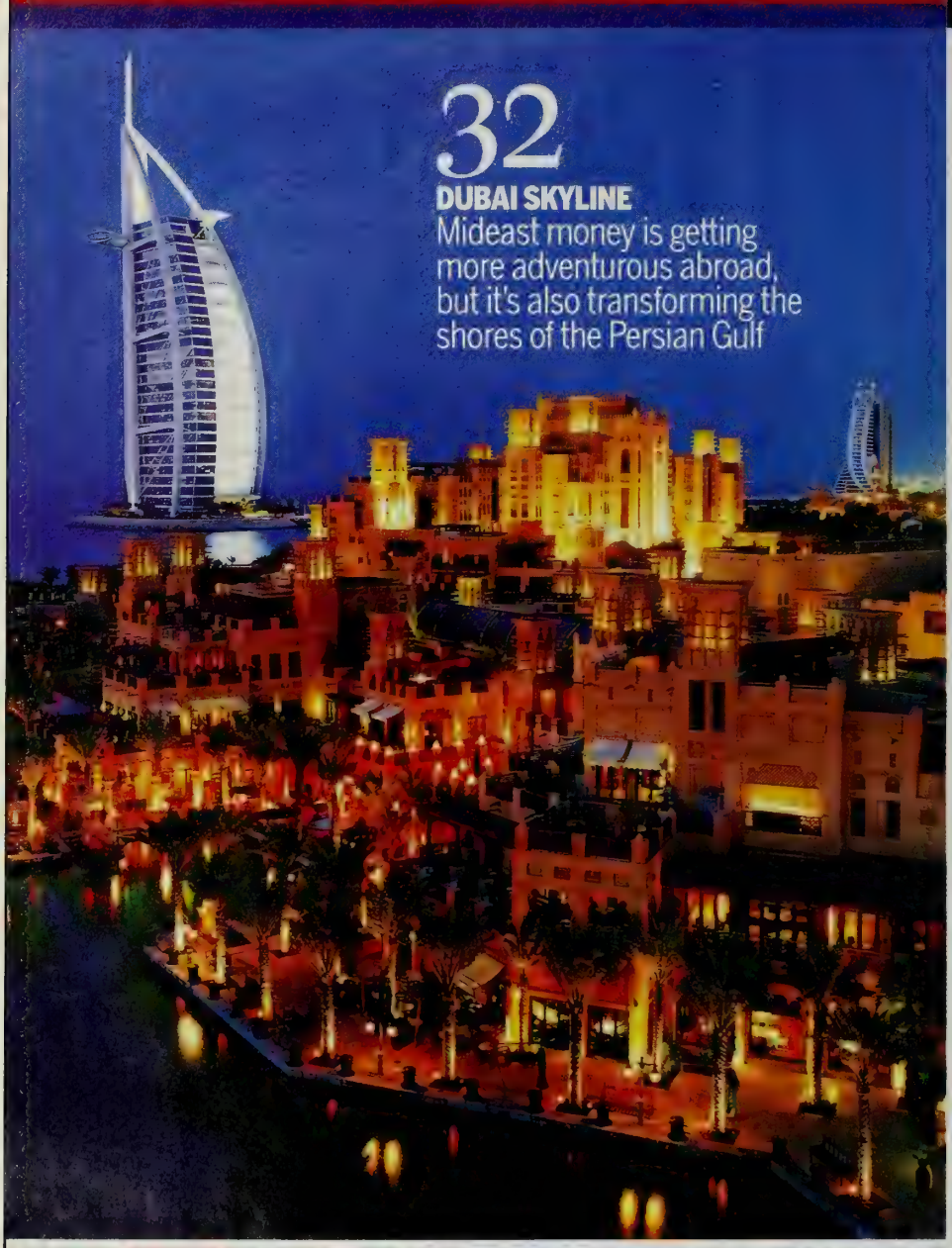

32
DUBAI SKYLINE
Mideast money is getting more adventurous abroad, but it's also transforming the shores of the Persian Gulf

80
THE FUN SELL
Hispanic TV ads are getting goofier

84
CLAIRE'S KIDS
Marla and Bonnie do Dad proud

Cover Story

32 The New Mideast Oil Bonanza
With the price per barrel stuck in the $55-to-$65 range, Persian Gulf states have hundreds of billions of dollars to invest. The Dubai Ports deal is just the beginning

38 The Fear Premium
Worries over an oil-supply interruption are driving prices higher and making Persian Gulf producers even richer

The Business Week

30 News You Need to Know
European protectionism; power deals; Stacey Snider jumps to Paramount; Bush in India; flats in Detroit; and more

News: Analysis & Commentary

42 A Large-Cap Rally? Nah
Analysts are saying stocks of companies worth more than $10 billion will beat the small caps. Why odds are against that

43 Reality Check for the Google Boys
The company is no longer blowing off Wall Street's demands. But is that going to be enough?

44 Ad Search Sabotage
Web advertisers have a growing problem: Scammers who charge for traffic from phony visitors

46 March Madness: CBS's Killer App
Its Webcasts of the NCAA basketball tournament could turn the corner for video on the Net

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ood Morning, Vietnam
s proposed factory in Ho Chi Minh
s bound to spur more investment

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good for U.S. exports

And a Stampede on Campus
; Mexicans see college as essential

alkman, the Also-Ran?
s all-new model is as unlikely to
e iPod in the U.S. as in Japan

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vernment

ashington Outlook
Senator. No laptops allowed

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iddle Kingdom and Midwest car
makers could be a neat fit

dback

masking An Ecnomics Debate
Mandel's recent cover story
sting that the economy is stronger
looks aroused passions on the Web

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ndant's Street Cred Prob
he conglomerate's efforts to revive
k price have bombed

oks Like a Debt, Rated Like a Stock
breed of hybrid security has Wall
all abuzz

cial Report

eaning Up Boeing
m McNerney rid the scandal-
d aerospace giant of its rot? He's
strong start—thanks in part to
oming business he inherited

ence & Technology

velopments to Watch
test for prostate cancer; precious
; cyber security

62

BOEING'S BOY SCOUT
Jim McNerney wants to can the infighting and develop a team culture. Then performance will be "unbeatable"

Information Technology

76 Yahoo Bobbles the Hat and Cane
Its effort to redefine online entertainment has been a surprising struggle

78 Open Season on Open Source
Aggressive acquisitions by others could co-opt the movement

Marketing

80 Laughing Out Loud in Spanish
After years of earnest Hispanic TV spots, advertisers are giving edgy and silly a go

People

84 A Boffo Sister Act at Claire's
The retailer has heated up since Roland Schaefer's daughters took over

Personal Business/ B-School Life

88 Going Global for an MBA
More B-school students are studying abroad, creating a worldly class of grads

90 Vive les Différences
On a French hilltop, business students from all over get a taste of teamwork

91 Making Those Connections Work
How a Dutch B-school helps its diverse student body develop lasting networks

92 Which Mother Knows Best?
Should she stay at home or go to work: A talk with the author of *Mommy Wars*

93 The New Aerobic Craze: Stairs
More people are taking them at the office

94 Play-by-Play Podcasts
Where to go for a sports fix

95 Personal Business Plus
Annuities may make sense for you; a high-rate Icelandic CD takes a hit; a Grant Wood exhibit at the Smithsonian

Columnists

22 Wildstrom: Technology & You
New tools for insatiable storage demands

26 Fine: Media Centric
Getting fans to write TV shows

27 Cooper: Business Outlook
U.S.: Business spending drives growth
Labor: Just how tight a job market?

96 Marcial: Inside Wall Street

102 Jack and Suzy Welch: The Welch Way
Strategy for small fry

Ideas

100 Books
Laird: *Pull: Networking and Success since Benjamin Franklin*

104 Outside Shot: William Beach
Applause for a Bush plan to analyze the economic impact of tax policy

Features

13 UpFront
18 Readers Report
20 Corrections & Clarifications
98 Figures Of The Week
99 Index of Companies

Office of Revenue Commissioners, Republic of Ireland

High-performance customer service, delivered.

To demonstrate how the public sector can improve customer service by embracing new technology, the Office of Revenue Commissioners, Republic of Ireland, wanted to introduce an electronic filing, payment and information system. Accenture developed and launched Revenue Online Service (ROS), a website that substantially simplifies the filing and payment process and provides online access to account information. The system uses digital certificates to give electronic tax returns full legal status. Introduced in September 2000, ROS has processed in excess of 6 million transactions and has brought in more than €21 billion in payments. ROS is now widely accepted by the Irish business community, and has allowed the Revenue Commissioners to establish a level of customer service and processing efficiency worthy of a high-performance government agency.

Thomas Cook

High-performance operations, delivered.

A 163-year-old brand with many owners over the years, Thomas Cook UK & Ireland was a respected but complex decentralized travel services business in need of a return to profitability. In an innovative co-sourcing arrangement with Accenture, the company created a shared services center to consolidate its widely dispersed IT, finance and HR administration operations. Responsibility for strategy and policy was retained by Thomas Cook, with Accenture facilitating operations management. In 16 months, the company removed £140 million in operational costs, helping to achieve an £83 million turnaround, establishing Thomas Cook as a high-performance player in the competitive UK travel business.

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Preventive health care: What you — your doctor and your company — can do today to help you stay strong tomorrow.

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How to Jump-Start A Lifetime of Saving

For twentysomethings just getting started, **investing for retirem** may seem like a distant chore. But saving for the future doesn't have to be painful and starting now will give you a nest egg to crack for weddings, kids, or rainy days. No 401(k) at work? No problem—BusinessWeek Online's **Smart Steps for Young Investors** offers five alternatives for getting a head start o retirement. For a hassle-free approach to saving, target-date life-cycle funds allow investing newbies to pick a retirement date. Then the fund allocation automatically adjusts over time. Our guide also includes tips for getting over that first hurdle: bad credit. And don't let housing prices scare you, either. There are ways **first-time home buyers** can get into the market without going broke. What about fun? Lest you think all that saving means no money left over for enjoyment we've included tips for setting cash aside for vacations, gizmos, or school. You'll find this **investing survival guide** at **www.businessweek.com/go/younginvestor**

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UP Front

"They made a fortune off of my last year...You barely heard the show, they ran so many commercials."

–Howard Stern, to the Drudge Report, protesting a CBS lawsuit claiming he misused airtime to promote his upcoming Sirius gig

ED BY DAN BEUCKE

CITY

RCELL'S ING-AWAY RSE

OWS LIFTED all over Wall last summer when got out that **Morgan** y was paying former hilip Purcell illion to go But the ntals of his ckage, as in Morgan's and flagged **tnoted.org,** n more ting. the rest of his life, , now 62, will get 00 a year to cover s "that otherwise have been available to llowing his termi- " The active hropist, whose causes e children's hospitals and inner-city music programs, gets an equal amount to fund favorite charities. Morgan pegs the present value of those benefits and donations at a combined $6.1 million.

PURCELL

Purcell also gets a secretary for life, at an initial salary of $115,000. With 3.5% raises, the cost comes to an estimated $1.9 million. Purcell received half his $44 million "bonus" in January. The rest is scheduled for January, 2007.

A spokesman for Purcell says the package is in line with that of other top Morgan execs and that he more than matches what the company pays toward his charities. Morgan declined to comment beyond the proxy.

–Elizabeth Woyke

HELP DESK

Geeks Bearing Gifts

LAWYERS AND CONSULTANTS have long lent their time, pro bono, to those in need. Why not computer engineers? Last fall, Charles Best, founder of **DonorsChoose.org**, a nonprofit Web site that connects teachers in need of supplies with individual donors, called **Yahoo!** (page 76) with an unusual request: Could the Web powerhouse please loan him six of its most talented techies for three months at a time to help redesign his site? Yahoo co-founder David Filo immediately signed on. The first group of volunteers is six weeks into the program.

Yahoo sees the contribution not just as philanthropy but as a tool in the red-hot tech talent wars. Its community relations director, Meg Garlinghouse, describes most of the company's hires as "predisposed to care for the community." A Peace Corps veteran herself, Garlinghouse thinks this will help Yahoo entice the most gifted geeks. They should help DonorsChoose's 19 employees catch up with the escalating demand for its services. Says Best: "Our current platform is still built around the Web site I commissioned four years ago, when we had no idea we'd grow beyond the Bronx." His goal is to make DonorsChoose available to every public school teacher in the nation by fall 2007.

–Jessi Hempel

BIG PICTURE

ABOUT SARBOX

ice execs are still coming ps with the Sarbanes-Oxley Ox) accounting oversight law, nearly ears after its passage.

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x has significantly increased my workload	75%
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x will be good for my career	29
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x has made me consider a career outside of finance	16

s were allowed to choose more than one answer
gazine's Jan. 9 survey of 237 senior finance execs at companies complying with Sarbanes-Oxley

UP Front

HIGHER ED

THE GREASE PITS OF ACADEMIA

STUDENTS AT Belmont Abbey College may have a head start in the race for postgraduation jobs—at least jobs that go vroom!

Starting this fall, the 1,000-student school outside Charlotte, N.C., will offer the nation's first four-year bachelor's degree in Motorsports Management. Students will study such topics as sports marketing and racing management. "The program will be **NASCAR**-focused but will have a broad application to all portions of the motor sports industry," says Philip Bayster, chair of the school's business department.

The idea originated with H.A. "Humpy" Wheeler, president of racetrack owner **Speedway Motorsports.** He saw a need to boost management talent in the booming race-car business. Charlotte, the NASCAR epicenter, is home to about 250 racing teams and 25 specialized media and marketing firms.

Pay is anything but the pits: A 2005 study by two University of North Carolina-Charlotte professors found that annual salaries for the region's 14,000 motor sports jobs, not including drivers, averaged $72,000. Gentlemen, turn your tassels. *–Coleman Cowan*

DOLL WARS

THEY'VE FOUGHT in toy aisles and in court. Now Barbie and Bratz are battling over bragging rights. MGA Entertainment boasted in early February that its Bratz had become the "No. 1 doll property" in the U.S. CEO Isaac Larian took some license, comparing different-size Bratz lines to Barbie, which offers mainly an 11.5-inch version. Mattel fired back, saying Barbie "continues to be the No. 1 girls' brand"—true, you include all branded merchandise—and th Barbie.com was the top Web site for girls, wit million monthly visits. Oops. It meant to say t all Barbie-related sites generated that much traffic. Larian pounced in a Feb. 23 statement "We were all confused by the 'statistics' that v being quoted. Now we know why they sounde wrong....They were." *–Christopher Pal*

BLOGSPOTTING

IT'S A CELL WORLD

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» **NOTABLE POST** "In Italy a new SMS service started for fresh-produce consumers last week called SMS Consumatori, that lets consumers know the average prices of fruit and vegetables by text messaging, is a success beyond every expectation, reports FreshPlaza. One million SMS [messages] have been exchanged."

DRAWN & QUARTERED

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UP Front

TOURISM

LOVING ALBERTA, TOO?

Brokeback Mountain headed into the Academy Awards as a favorite to win Best Picture. But can Alberta cash in? Although set in Wyoming, the movie was shot in the western Canadian province. Now Alberta officials are betting that fans captivated by the backdrop of soaring peaks and pristine rivers will want to see it up close. On Feb. 24 the province's tourism arm, Travel Alberta, sent cowboys to Manhattan to publicize its new Web site (inadvertently bringing to mind the 1969 Oscar-winning *Midnight Cowboy*). The province also is backing a big-screen Times Square promotion featuring the Canadian Rockies. "We are going out of our way to make sure people know where that gorgeous scenery is," says Travel Alberta's Don Boynton.

Tourism already is a $5 billion-a-year industry for Alberta. But Boynton is holding off on comparisons with *Lord of the Rings*, whose breathtaking cinematography sparked a tourism boom in New Zealand. "That was a trilogy with a much bigger marketing budget. Our expectations are tempered."

–Elizabeth Woyke

GADFLIES

A PROPOSAL WITHOUT A FACE

WHAT'S IN A NAME? A lot, if it's your own. Lloyd Noble II's grandfather founded what would ultimately become two large, publicly traded energy companies, **Noble Corp.** and **Noble Energy Inc.** This annual-meeting season, Lloyd Noble, who has never worked at either company but is a shareholder of both, is sponsoring proposals to split the chairman and chief executive's job at the two companies. He believes one person in both positions is too much concentration of power.

But shareholders may have a hard time figuring out who is behind the proposals. So far Noble Energy, a $2.2 billion oil and gas exploration company whose chairman and CEO is Charles Davidson, has agreed to include Lloyd Noble's proposal but it won't mention his name as a sponsor, according to correspondence he received. The company did not return *BusinessWeek*'s calls for comment. Noble Corp. Chairman and CEO James Day said through an assistant that his company, a $1.4 billion drilling rig operator, will reveal its position when it files a proxy statement.

Securities & Exchange Commission rules don't force companies to disclose the sponsor of a shareholder proposal. But most of them do, says Patrick McGurn executive vice-president proxy advisory firm **Institutional Shareholder Services.** The exception, McGurn says, is if it's a proposal the company opposes and it thinks th sponsor's name will carr clout with shareholders. "Some shareholder neec step to the plate," says L Noble. Just don't look fo name on the batting line

–Christopher P

IDENTITY THEFT

HACKING INTO THE IVORY TOWER

COLLEGES NEED a crash course in protecting data. Hundreds of thousands of names and personal data have been hacked in the past year—sometimes repeatedly. Schools that were struck include **Northwestern, Carnegie Mellon,** and **Stanford,** says **Privacy Rights Clearinghouse.** On Jan. 23 hackers nabbed Social Security numbers, credit-card information, and check images of **University of Notre Dame** donors. At **Kent State University** in Ohio, cybercrooks accessed a database containing names and Social Security numbers of 19,000 applicants. And in December, credit-card data and 5,500 Social Security numbers were stolen from **Iowa State University's** system.

Typically, data ends up with overseas organized-crime groups, often in Eastern Europe, says research fir **Gartner.** They are sold to counterfeiters over th Internet or used dire for financial fraud. Student IDs that use embedded chips for purchases are also a t

Why are universities vulnerable? Their systen from academic to admin tive, often operate indep of one another, with few layers of security. Forme **Microsoft** security expert Howard Schmidt, a prof at Georgia Tech, estimat that only 25% of college the data-protection test.

–Mara Der Hovanesi Breme

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> "While MTV Networks may be a leader in reinventing its brand, your story made little mention of MTV's dark side..."
>
> *–Assistant Professor Jeffrey Podoshen*
> *Franklin & Marshall College*

A STEADY STREAM OF MISOGYNY AND MATERIALISM

I WAS VERY DISAPPOINTED with "Can MTV stay cool?" (Cover Story, Feb. 20). While MTV Networks may be a leader in reinventing its brand, your story made little mention of MTV's dark side, which includes regularly playing music videos that largely feature misogynistic images and lyrics and espouse the "virtues" of materialism. MTV has taken the strategy of appealing to the "lowest common denominator" in order to obtain its widest reach.

–Jeffrey Podoshen
Assistant Professor of Marketing
Franklin & Marshall College
Lancaster, Pa.

TO TAKE THE MONEY OUT OF POLITICS, MAKE THE ADS FREE

AS A MEMBER of Congress for 22 years and a lobbyist for the last seven, I take issue with the conclusions in "Shakedown on K street" that lobbyist "money is vacuumed up to Capitol Hill by demands from members of Congress" (News: Analysis & Commentary, Feb. 20). Do these things happen? Yes. Are they the norm? No. The 11,500 lobbyists work for every conceivable cause in D.C. A few pay to play, but most do not. Most give because a lawm supports his or her view of the world o client's views. There is no quid pro qu

Lobbyists are advocates in a com system of legislation, just as lawyer in the world of the courthouse. The irony is that virtually all money raise politics is not for the politician's pers benefit, for if it is shown to be so, he o goes to jail. No, the vast portion of m in politics goes to the press so the p cian can get his message out, thereb abling the press to pay their airhead reasonable sums of money and conc the supporters of politicians for supp the cash in the first place. If you wa take money out of politics, suggest the press carry political messages for

–Robert Livin
Member of Congress (Re
Washin

Editor's Note: The writer represe Louisiana's First Congressional Di from 1977 to 1999.

THE TROUBLE WITH FOR-PROFIT SUPPLEMENT OVERSIGHT

IN "HOW SAFE ARE diet suppleme (Science & Technology, Jan. 30), rep John Carey omitted crucial informati

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to why persons such as myself are critical of ConsumerLab.com. If you pay CL $3,500 per product to use its logo, then on any other product that may later be found to be deficient, CL will work with you to fix the product and not publicize your name. That is why some industry members describe CL's tactics as "name and shame." I have accused CL of attacking and painting with a broad brush otherwise good companies. They are also not a lab: They use outside labs, meaning they do not have to hold themselves to good laboratory practices.

On the ginkgo biloba issue, Carey writes: "Jarrow says that a Chinese supplier was at fault." No! I said, clearly, that an employee of Jarrow didn't do his job, that we had been testing that supplier's product at first, and the employee was reprimanded because the testing had been inexplicably stopped. More than that, I said I had flown to China, inspected the plant, saw the ethanol extraction-resin beadlet technology, that freeze-drying and not just spray-drying was used, that they had an adequate lab, and approved them as a supplier. I told Mr. Carey that we undertook a recall and that we changed suppliers.

–Jarrow L. Rogovin
President
Jarrow Formulas Inc.
Los Angeles

Editor's note: CL President Tod Cooperman says if you pay $3,500 per product, CL will test each product in its certification program. If a product fails, ConsumerLab will not publicize the failure. If it passes, CL will post that on its Web site. Cooperman says CL does not target companies that do not pay for its services. It uses outside labs, he says, to take advantage of their different areas of expertise and to confirm results with a second test.

A FEW WORDS FROM THE FOUNDER OF SUPERFUND

I AM WRITING to thank you for conveying my vision of bringing sophisticated investment products such as Superfund to retail investors ("Welcome to Superfund," Special Report, Mar. 6). I would like to clarify several points: The article states that "Superfund tries to boost its returns by investing with lots of borrowed money" which allows it "to buy contracts with face value that far exceed invested equity, magnifying potential profits—and losses."

In managed futures, every investor puts down less money than the face value of the futures contract being purchased. We employ various degrees of leverage to maximize returns. However, Superfund does not borrow money in the conventional sense of going to a bank for a loan. Furthermore, with regard to the Superfund Q-AG series, for example, only about 30% of the assets of the fund are used as margins for trading futures contracts. Most of the holdings are invested in government-backed bonds that earn interest for investors while being used as security to cover any potential trading losses.

The article also discusses the performance required "just to break even" in light of the management, sales, brokerage and other fees. All of those fees are factored into reported returns.

Finally, I think the volatility charts under the heading "Super Performance" could have made it clearer that Superfund's cumulative returns over the 10-year period (531%) far exceeded those of Tremont Managed Futures Index (111%) and Tremont Hedge Fund Index (182%).

–Christian Baha
Superfund Group
Monaco

CORRECTIONS & CLARIFICATIONS

"Welcome to Superfund" (Special Report, Mar. 6) stated that financial adviser John Valentine has suggested that some wealthy clients allocate 18% to 22% of their portfolios to Superfund for diversification. Mr. Valentine says the figure is 10%. The 18%-to-22% range, he says, represents what he might recommend for investments in all Non-Correlated Asset Classes.

In "Rated M for Mad Ave" (Marketing, Feb. 27), we reported that Engage In-Game Advertising, a video game media-buying service, inserted ads on behalf of its client, Subway Restaurants International, into online games via a Net ad server and modified, without permission, Valve Corp.'s video game *Counter-Strike*. Rather, Engage placed ads through in-game advertising company IGA Worldwide, which settled the dispute with Valve after we went to press.

"How the IPO market got its buzz back" (News: Analysis & Commentary, Feb. 27) should have clarified Ian Schrager's relationship with Morgans Hotel Group Co. Schrager resigned as chairman and CEO in 2005 but will remain a consultant to the company through 2007.

THE HOTEL BIZ SAYS DON'T SCARE THE GUESTS

"CHECKING IN? First pass the picket line" (News: Analysis & Commentary, Feb. 20) implied that unionization leads to higher wages. The fact is that b nonunion and union hotels pay comp tive wages. They can vary from city to but this is based largely on local cost living differences, not the level of uni ization. That's why hotels are commi to working with local unions to find a lution that is fair to our employees. hotel industry firmly believes we reach agreements that provide our w ers with the job security and benefits need to maintain a good quality of lif

In addition, it's important for the p lic to know that with labor contracts piring this year, the hotel industry fulfill its obligations and responsibil to its guests, too. Our guests can alv rest assured that they will continue t ceive the same high-quality service have come to expect from our memb

–Joseph A. McIne
President &
American Hotel & Lodging
Washin

DO THE MATH: SAVVY STOCK-PICKING IS A MYTH

RE DR. ANDREW W. LO'S research the cognitive psychology of inves ("Darwinian investing," Voices of I vation, Feb. 20): Many a Nobel prize- ning economist and most of the aca ic community (at least those who work for hedge funds) concede that s market returns are over 95% explain by factors such as a portfolio's ave market capitalization and average multiple, not one's ability to pick st better than the next guy. In fact, by t to outsmart the other guy it is al mathematically certain you will u perform the market over the long te

–Steven A. We
Park Ridg

How to reach *BusinessWeek* International

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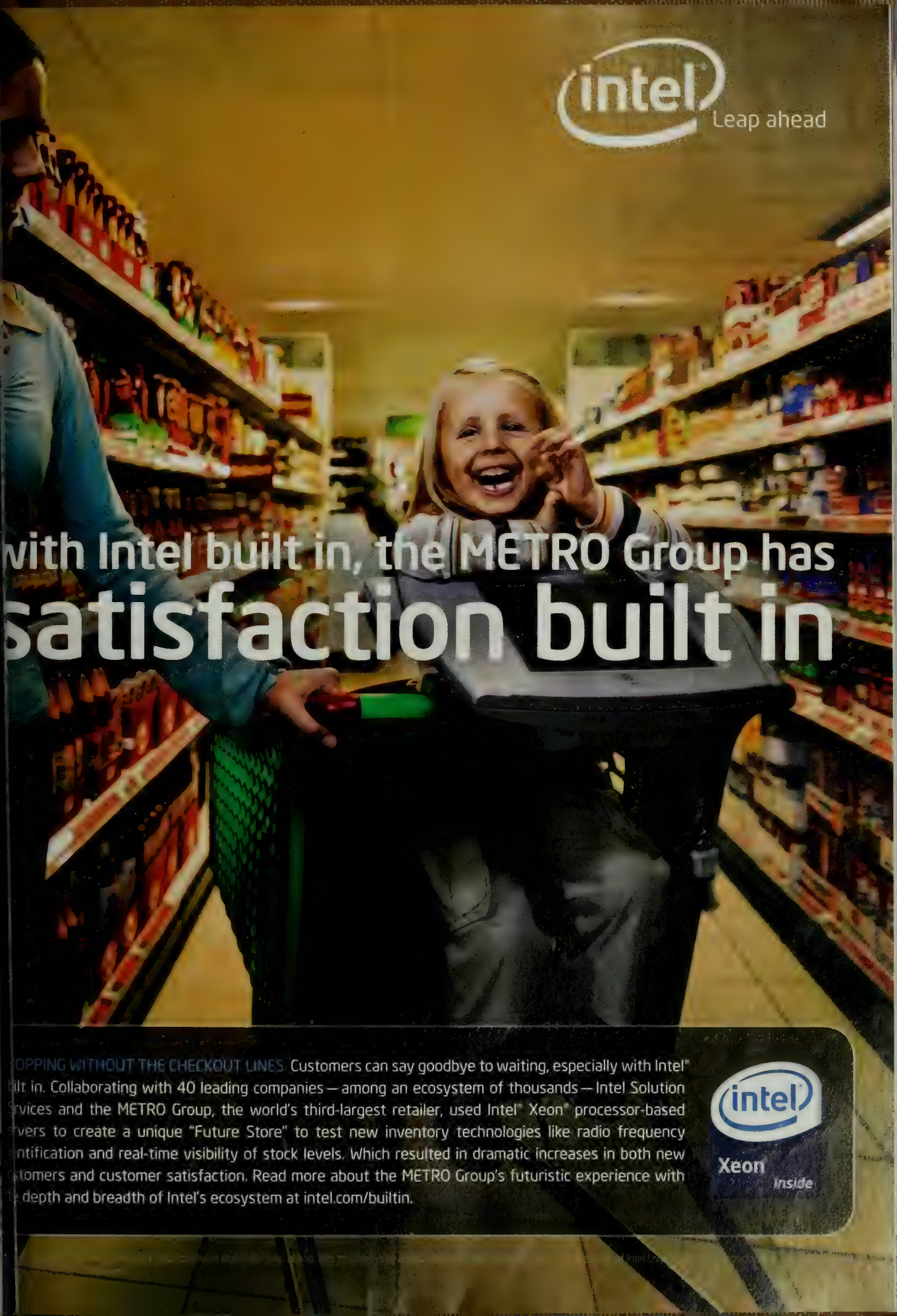
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BY STEPHEN H. WILDSTROM

Space: The Digital Frontier

You can't have too much storage. I used to think this rule applied only to closets and garages. But the explosive growth of digital media means tha PC disk drives with 60 or even 100 gigabytes, which once seemed limitle are filling up. Fortunately there are solutions that both solve your storage problems and make sharing content on a home network much simpler.

Remember when Windows 95 was first introduced? Most PCs at the time couldn't hold much more than 2 GB worth of files. Maybe they didn't need to because what we were storing was mostly text. A book as weighty as *War and Peace* would take up less space than a single digital photo or song. Now the world has moved to space-hogging "rich media," such as pictures and music. Just one high-quality song file can chew up 10 MB, a half-hour of ordinary television needs a gigabyte or more, and high-definition TV requires three times that much. Your current desktop PC may hold up to 250 GB, but even that doesn't seem to be sufficient.

Fortunately there are some exciting new ways to stash all that stuff. For a home network, there's a whole class of simple, low-cost storage devices that plug into the network rather than into a PC. These "network drives" make it much easier to access information from multiple computers and can also back up data automatically from connected PCs.

I tried two systems using different technologies. Maxtor Shared Storage Plus, a box about half the size of a laptop, is a miniature version of the sort of file server used on corporate networks. Capacity ranges from 200 GB (about $220) to 500 GB (about $500). It's easy to set up from any Windows PC, and since its technology is supported by all modern operating systems, it can be shared by PCs, Macs, and even Linux systems on the same network.

ONE OBVIOUS USE FOR NETWORK STORAGE is sharing your collection of digital music. You can put all your music on a network drive, which each family member can then access through iTunes or some other music player. (This won't work with some copy-protected songs.) And with Shared Storage Plus, each user can send music, photos, or video to anyone else on the network as long as the players adhere to standards of the Digital Living Network Alliance. These standards have caught on in Japan and are likely to become more common in other markets over the next year or two.

Netgear's Storage Central SC101 costs less than the Maxtor device but is more of a do-it-yourse project. For about $100 you get a b that's about half the size of a shoeb into which you can pop one or two standard desktop-type hard drives giving capacity of anywhere from 4 to 1,000 GB (for anywhere from $5 about $350 per drive). The SC101 employs advanced technology usec large databases in corporate data centers. Its main selling point is th the network drive appears in Wind "My Computer" just as if it part of your PC. The drawba that you need to install softw on each PC that will share da and Netgear's program runs on Windows.

New storage systems help PCs handle the insatiable demands of "rich media"

Either of these systems is for backing up important da files. Both come with their o software to control what is archived, and when. But the new and more interesting method available called continuous backup that sen copies of your files whenever a new version is saved. I tri two different programs: Memeo AutoBackup ($49.95 fo to three computers) and IBM Tivoli Continuous Data Protection ($35). Memeo is simpler to set up and use, bu Tivoli, another scaled-down version of a corporate-class product, offers greater flexibility.

Which device is right for you? If opening a computer makes you nervous, Maxtor is probably the better choice Technical predilections aside, a network drive is an exce way to get a lot of flexible storage for not much money.

E-mail: techandyou@businesswe

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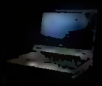

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Putting the Fans to Work

What would happen to pop culture if there were no rabid fans? What if n one indulged in the borderline behaviors of the adult Trekkies who assemble massive action-figure collections or sports fans who paint their bodies in team colors? ¶ For one thing, there would be no fan fiction—fa written works starring characters from beloved series, movies, books, or even video games. Examples by the thousands are on sites such as fanfiction.net. I won't try to convince you that most fan fiction is comprehensible or even bearable to outsiders, which is why godawful.net ("the foulest fan fiction available") has thrived for years. But there is something affecting and heartfelt about the phenomenon. Given fans' intensity and devotion and the myriad ways media profit from preoccupations with stardom, it was inevitable that some outfit would smell a business in all this.

Which brings us to FanLib. If all goes according to plan, FanLib will bring fan fiction from obscure corners of the Web into the light—a very postmodern form of mainstream entertainment in which a show's content, its fans, and its marketing intertwine. FanLib, based in West Hollywood, Calif., is running a complex online script-writing contest for fans of Showtime's soapy and sapphic *The L Word*—its first effort for a TV series. To cite a sitcom cliché, it's a crazy idea, but it just might work.

***THE L WORD* CONTEST, WHICH** assembles a full script scene by scene, began in late January and lasts through March. The show's real (paid) writers outline a scene and give guidance. Fans have about a week per scene to submit offerings, peruse others', and vote. One grand prize winner gets a script-writing session with *L Word* creator Ilene Chaiken and a $2,000 credit at Saks Fifth Avenue, which, along with LendingTree and W Las Vegas, sponsors the competition.

The marketers, in turn, get an exclusive shot at *The L Word* fans, since Showtime is ad-free. They also bring in some revenue for FanLib and the cable network, although Showtime Chief Executive Matt Blank concedes that the dollars aren't significant. But, coincidentally or not, the network says viewership this season is up around 50% (Nielsen does not release Showtime ratings) and that *The L Word* site has become Showtime's most trafficked. In a recent round, 177 scenes were submitted, and more than 17,000 votes were cast. "I'm not sure why we wouldn't want to keep going on" with such promotions, says Blank.

FanLib is the most current example o marketers harnessing their fans' do-it-yourself efforts to build buzz and cut marketing costs. In late 2004, sneaker Converse solicited its customers to mak ads and ultimately ran 30 of them on T This move made much noise and saved production fees, since there were none.

Judging from one contestant, *The L* promotion exerts a strong pull. "We we checking [the site] all the time," says Jasmine Beach-Ferrara, a 30-year-old resident of Asheville, N.C. If the hope is FanLib entrants become avid word-of-mouth promoters, Beach-Fe delivered: "We launched a g out-the-vote campaign" involving "shamelessly self-promoting e-mails." (Alas, scene did not win.)

> The media are trying to cash in on viewers' obsessions

The genius of FanLib is realizing that fans can be h just being recognized. The don't have to rival those of *Wants To Be A Millionaire?* Showtime is quick to note unlike with Converse, there's no guarantee that the wi scenes will ever be produced. FanLib will only work fo some fare, because, for reasons buried deep within po culture's DNA, fan fiction explodes only with certain sh (*Star Trek* is the granddaddy of the form; another biggie *Buffy the Vampire Slayer*.) Still, Pepsi will sponsor an unspecified FanLib project, and FanLib is developing a film written by genre geeks.

It's easy to sneer at all this screenwriting by committe you realize that's basically how Hollywood works. And w comes out of that ultra-pricey process are messes like *Fa Four* and *The Dukes of Hazzard*. Fans, on the other hand, write for next to nothing. The result might even be filma

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

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JAMES C. COOPER

Now It's Business That's Stoking the Boiler

pital spending and hiring are driving growth. Will they drive up inflation?

U.S. ECONOMY By now, everyone knows that first-quarter economic owth is going to be a ripsnorter. Many analysts already have pushed their forecasts north of 5%. But what's getting lost in all the ention to this quarter's growth surprise is mounting evidence that a ntral theme of most forecasts for 2006 is playing out right on

dule: Business is taking on a bigger role in driving all growth. That means, despite the emerging ing slowdown, businesses are taking up some of the , as they shell out for new equipment and buildings, inventories, and additional workers.

ter more than four years of steady growth since the recession ended, the economy has reached a sweet Businesses are increasingly confident about future and both at home and from abroad, and their nism is generating new demand and income ghout the economy. It's a classic virtuous cycle s hard to break, except perhaps by a major shock that es businesses to pull back sharply.

roughout this decade, companies have tiptoed gh one uncertainty after another that kept them ous and conservative. Now, two things are ening. Businesses have increasing faith in the e, and their past caution has created the need to nd in order to meet demand. Even after last year's st turbulence, when oil prices surged anew in the alf—before the hurricanes sent oil spiraling even r in the second half—companies appear to have oped a steely resolve to keep growing, simply se they must.

to last year, businesses tried to satisfy demand with ng facilities and workers, but they have taken short- gains in productivity as far as they can. The nination to keep growing has been fortified by g growth in profits, record cash flow, solid balance s, exceptionally low debt, and easy borrowing tions in both the credit and equity markets. Those lid supports for overall economic growth this year.

NEW ATTITUDE AT COMPANIES shows up in two surveys of business executives and in the latest mic data. The Business Roundtable says optimism boardroom is high. The CEO Economic Outlook , a measure of executive expectations for sales, l spending, and hiring over the next six months, nded sharply in the fourth quarter and gained a bit ground in the first quarter, according to the 125 ny chiefs in the Roundtable's survey (chart). Most xpect strong sales and remain optimistic about capital spending, and employment expectations are the strongest since the the survey began in 2002.

Another canvass, this time a fourth-quarter survey of 135 chief financial officers and managing directors at U.S.-based companies by PricewaterhouseCoopers, showed solid increases in company projections for the coming year for expected revenue growth, new investments, and hiring compared with the third quarter. Those results were also a big rebound from the third-quarter expectations, which were depressed by the uncertainties, disruptions, and higher energy costs resulting from the hurricanes.

CEO EXPECTATIONS REBOUND STRONGLY

Data: Business Roundtable

In all, PWC says 70% were optimistic about economic prospects over the next 12 months, a 20-point bounce-back from the third-quarter reading. The survey shows that concerns persist, especially for energy-sensitive businesses. But even among those who saw rising energy prices as a potential barrier to their company's growth in the coming year, 66% were optimistic, up 22 points from the third quarter. "What we're seeing is a major quarter-to-quarter turnaround by leaders of large U.S. businesses," says PWC Vice-Chairman John O'Connor.

HARD DATA SUPPORT these upbeat attitudes. As widely expected, the Bureau of Economic Analysis revised its initial estimate of fourth-quarter economic growth upward to a 1.6% annual rate from the 1.1% pace originally reported. Part of that refiguring included sizable upward revisions to growth in business investment in both new equipment, from 3.5% to 6.2%, and new buildings, from 0.7% to 3.3%.

Both of those sectors are set to post considerably stronger results this quarter, based on the trends in orders and output for capital goods and outlays for business construction. January orders for capital goods,

excluding the monthly gyrations caused by the military and commercial aircraft, stood far above their fourth-quarter level. Further strong output gains are on the way, as orders continued to outpace shipments, pushing the January backlog of unfilled orders to a record level.

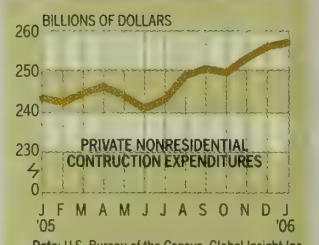
Production of business equipment also started the year well above the previous quarter, and factory activity more broadly picked up in February, says the Institute for Supply Management. The ISM's Purchasing Managers' Index rose to 56.7% last month, from 54.8% in January, as new orders, production, and employment showed improved momentum.

New construction is gaining as well. One often-overlooked factor in the outlook is that new building by businesses is starting to accelerate just as housing construction is beginning to slow. In January, sales of both new and existing homes fell, but construction spending by businesses posted another strong advance, and the growth pace has picked up sharply since last June (chart).

SOME OF THAT PICKUP includes post-Katrina rebuilding, but more importantly it reflects businesses' need to expand in the face of pressure on existing facilities and labor. For example, plant utilization rates in manufacturing have risen to levels close to those seen in 1999-2000, as output has accelerated while production capacity continues to grow only modestly.

For some companies it's a game of catch-up investment. Following the tech-led investment bust five years ago and the subsequent corporate caution, capit spending as a share of GDP remains unusually low at advanced stage of recovery, and depreciation rates relative to capital expenditures remain unusually high Businesses have not been replacing older equipment the rate you might expect, given the economy's streng

BUSINESSES SHELL OUT FOR NEW BUILDINGS



Data: U.S. Bureau of the Census, Global Insight Inc.

New investment in coming year will be especially critical for companies to stay competitive, both in t U.S. and globally. So businesses have man their costs well, even the face of $60-per-b oil. The PWC survey shows that, by and la gross profit margins actually improved through the end of la year. However, one strategy for coping with higher co is not the method inflation-phobes at the Federal Res would like to see. PWC says companies are getting a l more help from increased pricing power.

So renewed business optimism may be both a bles and a curse. New capital spending and hiring will ea concerns that a housing slowdown could weaken the economy. But with labor markets and operating rates already tight, the need for more workers and product capacity could generate new pressures on inflation. ■

LABOR

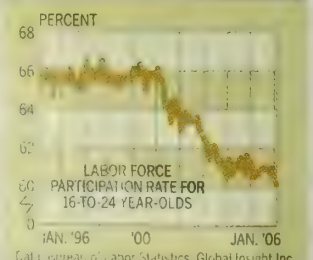
Just How Tight Are Job Markets?

WHEN THE FEBRUARY employment report comes out on Mar. 10, it will surely reignite debate over the tightness of the labor market. Some economists say the svelte jobless rate of 4.7%—the lowest level since the late 1990s—makes job markets appear tighter than they are.

They point to the low labor-force participation rate, the percentage of the adult population that is employed or actively seeking a job. The participation rate remains well below its pre-recession level of the late 1990s, suggesting that a lot of potential workers have simply quit looking for a job.

The degree of labor market tightness hinges on how many people not counted in the official jobless rate would work if given the chance. People who have not actively looked for a job in the past four weeks are not officially considered a part of the labor force and thus not captured in the jobless rate. But as job markets improve, those people might easily dust off their résumés and start job hunting. The participation rate is now at 66%. But if it were above 67%, as in the late '90s, close to 2.5 million more people would be in the workforce and the official jobless rate would be higher.

SCHOOL FIRST, WORK LATER



Data: Bureau of Labor Statistics, Global Insight Inc.

However, an alternative measure of joblessness, which counts as unemployed those willing and able to work but not searching, is also declining. This rate, called U-5 by the Labor Dept., was 5.7% in January, down from 6.4% a ye ago. The current level is compar to that in 1997, the last time the official rate was as low as it is no points out economist Michael Fe at JPMorgan Chase. The alternat rate implies that discouraged wo are not why the participation rat lower, and why it is unlikely to sl back up.

The reason is structural. The number of 16- to 24-year-olds in workforce has been falling as m young adults go to college. Since the participation rate for this gr has plunged from 66% to 60%. are not going to see 16- to 24-ye olds go back into the labor mark masse," says Feroli.

If so, and the overall participa rate stays down, then the Fed co face added pressure to keep rais interest rates to assure that tigh markets don't stoke inflation. ■

-By James Mehring in Ne

THE I CAN'T DEAL WITH ALL THIS DATA ERA IS OVER.

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The Business Week

News you need to know

EDITED BY HARRY MALLER

Protectionism in Europe Not in my house, you don't. Economic nationalism is rearing its head once again as France and Spain maneuver to fend off takeovers of domestic utilities. Italian energy group **Enel** wants to buy Paris utility giant **Suez**, but on Feb. 27, France unveiled plans for state-controlled gas outfit **Gaz de France** to marry Suez instead. Meanwhile, Spain is pushing a wedding between Madrid power company **Endesa** and Barcelona's **Gas Natural** to stop German utility **E.ON** from sweeping Endesa off its feet with a handsome offer.

The informed suitors note that such moves flout the **European Union**'s push to integrate energy markets. Italy has asked Brussels to step in. But legal experts say that while the French and Spanish deals would violate the spirit of integration, they may not run afoul of antitrust laws.

See "Europe's Utilities Stay Close to Home."
www.businessweek.com/go/tbw

Power Deals in the U.S. The utility industry is lighting up acquisition building in the U.S. too. On Feb. 26, Brooklyn's **AES** accepted a $7.3 billion offer by Britain's **National Grid** that will create the third-largest utility in the U.S. Meanwhile, the Wall Street Journal says Dallas-based **TXU** may sell part of its distribution business, possibly to **GE**. TXU declined to comment. Last year, Congress undid the Depression-era law that restricted utility mergers. The repeal took effect on Feb. 8 and is likely to send megawatts of financial electricity coursing through the business.

Colgate's Next Honcho Unconventional to the d
Colgate-Palmolive CEO Reuben Mark, who once wore a
tail and hasn't done a press interview in at least a de
chose to reveal his successor at a 7 a.m. analyst confe
in Arizona on Feb. 24. The choice, **Ian Cook**, a Colgate v
an who was named president last year, is less surpr
than the nonchalant manner of his announcement. He'
the job in 2007, with Mark remaining chairman
while. Colgate, the world's largest oral-care brand
been warring with **Procter & Gamble** in both the U.S
juicy foreign markets like China. But results got brigh
2005, and Mark promised more dazzle down the line.

Dubai Ducks Peppered with birdshot from **Capitol**
and with the **Bush Administration** hunting for cover—
Ports World agreed on Feb. 26 to submit to a new, 4
security review for its planned takeover of manage
dunes at six U.S. ports.

See "The New Mideast Oil Bonanza," pa

Stacey Snider's Dream Job Looks like **GE** didn't
enough good things to life for Stacey Snider, the 44
old head of **Universal Pictures**, who is jumping to **Para**
Pictures to oversee its newly acquired **Dreamworks** li
tion studio. Snider, the creative force behind such Uni
hits as *40-Year-Old Virgin* and *Meet the Fockers*, was s
have chafed under GE. She was especially dismayed
after months of negotiations, the tight fists at GE
Dreamworks into the arms of Paramount, which gra
it for $1.6 billion.

See "Stacey Snider Up Close," Face Time, BW—

The Avian Flu Watch No place seems safe from bi
Just days after **France** became the first EU member to
an outbreak of the H5N1 virus at a turkey farm, **Ge**
confirmed on Feb. 28 that a domestic cat in Bavaria o
the disease, probably from eating an infected bir
Sweden detected the virus in wild ducks. The eco
pain is already spreading: Although cooked poultry
no danger, some 43 countries have banned French
On Mar. 1, **U.S. Health & Human Services Secretary M**
Leavitt said bird flu could hit the U.S. soon.

Deutsche Bank May Settle Call it the case
phantom transactions. *The New York Times* said on F
that **Deutsche Bank** is trying to settle a **Justice Dept.**
into tax shelters the Frankfurt bank may have set
U.S. customers. If so, it would follow Munich ban
which in February paid $30 million and acknow
criminal wrongdoing in a similar case. But the *Tim*
Deutsche may have a tougher time because it can't
up with documents for some of the loss-making
trades, and swaps on which the shelters were ba
bank spokesman declined to comment.

Bush Goes to New Delhi There's a small radi
cloud hanging over **President George W. Bush's** first

lia, which began on Mar. 1. Most of his agenda was asant enough: He's expected to sign business and tech-ogy transfer deals in Delhi and Hyderabad, though he's ıbbing the Taj Mahal. But he may also ink an accord al-ing for U.S. sales of civilian nuclear technology if India ees to separate its civil and military nuke operations. ıt has critics growling in both nations. In the U.S., ere Congress would have to O.K. the deal, they're un-py that Washington might exempt nuclear-armed ia from export controls; in India, that **Prime Minister mohan Singh** is giving way to foreign pressure. Overall, ugh, U.S.-India ties have never been more cozy.

See "Wooing India with a Capital W" and "Bush's Visit ighlights India's Growth," www.businessweek.com/go/tbw

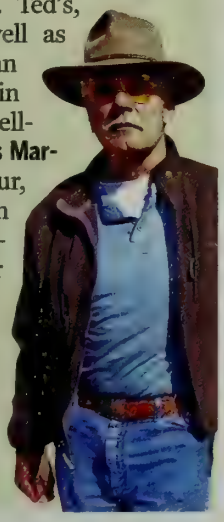
ogle Jitters How jumpy are **Google** investors these s? Wall Street responded on Feb. 28 to an unsurprising ement by **CFO George Reyes** that "our growth rates are ring" by knocking 7% off the stock price.

See "Reality Check for the Google Boys," page 43

re Flats in Detroit Adding insult to injury for the auto industry, *Consumer Reports* on Mar. 1 named its 10 vehicle picks—and for the first time they're all nese marques. On the same day, carmakers reported uary sales. **GM** slipped 3%, and so did **Ford,** minus its opean brands—but its **Volvo** and **Jaguar** units crashed double digits. One bright spot: **DaimlerChrysler's sler Group** sales accelerated 3%. Then look at the ns: **Toyota** up 2%, **Honda** up 9%, **Nissan** up 2.2%, ki up 39%. **Mercedes, Volkswagen,** and **Porsche** all ed zippier numbers, too.

Second Career of the Week

ow another bison on the barbie, Ted. Nine years r selling his media holdings to **Time Warner,** maverick **Turner** is bidding farewell, announcing on Feb. 24 that quitting the board after its May annual meeting. ll spend more time on philanthropy, his 1.7 million-s acres of ranchland—and his real growth vehicle, the **s Montana Grill** restaurant chain. Ted's, ch features bison burgers as well as non, chicken, and steaks, began 1 one eatery in Columbus, Ohio, in 2 and is already up to 39. It's also sell-its chili and beans in **Whole Foods Mar-**. The 67-year-old cable entrepreneur, launched **CNN** in 1980, had been npy with Time Warner since its ill-red 2001 **America Online** merger of late has sold much of his 4% e, once valued at $9 billion. He's ght to be down to about 0.7%, h $600 million. That may be far his glory days, but Turner's esti-d net assets of $2 billion will a heck of a lot of bison.



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The New Mi

DUBAI DREAMS
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2 Why small caps may beat big caps again
43 Has Google started listening to the Street?
44 The war on search-ad fraudsters
46 CBS's Web play for March Madness

le East Oil Bonanza

Beyond the Dubai Ports deal: Where all those billions are going. BY STANLEY REED

IF THE BURJ DUBAI DEVELOPMENT isn't the biggest project in the world, it must be close. At night under floodlights thousands of mostly Asian workers in hard hats swarm over a 500-acre building site in the heart of Dubai, the Persian Gulf emirate that is tiny in size but limitless in ambition. Emaar Properties, a local company, is carving out of the desert a new $20 billion district with 30,000 homes, a Giorgio Armani-designed hotel, an ice rink, and a 30-acre man-made lake.

The centerpiece of the project, which employs more than a dozen American firms, is Burj Dubai, a $1 billion tower. It was designed by Chicago architects Skidmore Owings & Merrill LLP, and its construction is being managed by New York-based Turner Construction Co. "We are moving up one floor a week, and we are now on the 31st floor," says Mohamed Ali Alabbar, Emaar's chairman. The exact planned height is shrouded in secrecy to foil competitors, but Alabbar promises that the luxury residential complex, more than 2,500 feet high, will be "40% taller than anything else."

PRINCELY SUM Alwaleed's Kingdom Hotel Investments raised $397 million in its IPO

The world's tallest building? In Dubai? The city-state in the United Arab Emirates captured headlines in the U.S. recently when government-owned Dubai Ports World, through its purchase of Britain's Peninsular & Oriental Steam Navigation Co. for $6.8 billion, agreed to take over management of several major ports, from New York to Miami. The deal has sparked an outcry among politicians worried that an Arab-owned company could be a vehicle for al Qaeda operatives. The uproar has forced the company to delay its plans in the U.S.

The Dubai Ports deal, though, is just one relatively small episode in the second great Mideast oil boom. The boom is characterized by hugely ambitious projects that are transforming the shores of the Persian Gulf into a Xanadu with some of the most fantastic and expensive structures on earth. The rush of petrodollars is creating enormous private and public wealth and reshaping Gulf business and society.

All this is happening when the other Mideast—of Iraq, radical Islam, and Palestinian-Israeli relations—is wracked by violence and strife. That turmoil could certainly threaten the Gulf's prosperity. Just look at what happened in late February when al Qaeda fighters unsuccessfully attacked a key oil facility in Saudi Arabia. But for now the authoritarian regimes running the Gulf are seizing the opportunity to build new economies and satisfy their restive populations with a new level of affluence.

The tale of Mideast money is not just a local story, however. This year, with oil prices stuck in the $55-to-$65-per-barrel range, perhaps half a trillion dollars will land in OPEC coffers—more than at any time since the boom of the 1970s and 1980s. The Mideast oil states alone will gather in $320 billion in oil and gas export revenues.

Where is that money going, how is it af-

FLYING HIGH Emirates has $37 billion worth of planes on order

fecting the global economy, and wha pact will the boom have on U.S. rela with the region? Those are crucial tions. The last oil boom, from 1973 to had dire consequences. The oil price created a lethal mix of inflation and growth worldwide. Arab states, u pared for their newfound wealth, s too much money away in U.S. Treas and a few international banks. The in turn lent the money to Latin Ame

The Mideast Oil Boom: How the Money Is Flowing

Oil-exporting nations in the Middle East are thriving

Data: PFC Energy NOTE: DATA FOR SAUDI ARABIA, IRAN, UN RATES, KUWAIT, QATAR, ALGERIA, AND LIBYA *INCLUDES ALL FOREIGN ASSETS HELD BY GOVERNMENTS AND OF

(L TO R) PHOTOGRAPHS BY OWEN FRANKEN/BLOOMBERG NEWS

rnments. In the end, these countries in't pay it back—and instead trig- d a debt crisis that shook the global fi- ial system.

his time around the impact of money- s from the Mideast does not appear so toxic. The oil exporters are spend- much more at home on investment consumption, helping to shore up al demand for goods, and balancing e effect of their huge export earnings.

But Mideast money is definitely venturing abroad. For starters, a chunk of the billions is going to deals in the U.S., Europe, and Asia. Dubai Ports did not just cut a deal for P&O: It also bought the port operations of Florida's CSX Corp. for $1.2 billion. Last year, Dubai luxury hotel group Jumeirah bought the swanky Essex House in New York for an estimated $400 million. Dubai International Capital, the private-equity arm of Dubai Holding, the government's oil money depository, paid $1.5 billion for Madame Tussauds, the British wax museum, and an additional $1.2 billion for a 2% stake in DaimlerChrysler. Mubadala Development Co. of Abu Dhabi acquired a 5% holding in Italian carmaker Ferrari. In the biggest Mideast deal of all, Egyptian cellular operator Orascom Telecom Holding formed a consortium to buy Wind, a top Italian mobile network, for $13 billion. "These investors have an incentive to invest in assets outside the petroleum industry," says Thomas J. Barrack Jr. His Colony Capital LLC recently partnered with Saudi Prince Alwaleed bin Talal to buy the Toronto-based Fairmont Hotels & Resorts Inc. for $3.9 billion.

Mideast oil exporters should take in some $320 billion this year

On the Hunt

THE NUMBERS involved in these deals are still small compared with the billions being spent in the region. Bankers in the Mideast, however, say both governments and family companies controlled by Gulf billionaires are becoming more adventurous. Beat Naegeli, the Dubai-based head of Credit Suisse Dubai private banking in the region, says big Arab investors, while still predominantly invested locally, are increasingly on the hunt for equity stakes in overseas companies and real estate deals in New York, London, and Paris. Many of these investors, he says, are currently expanding their private-equity po-

Is Benefiting

What They're Buying

CHARTS BY ERIC HOFFMANN/BW; MAP BY ALBERTO MENA/BW; PHOTOGRAPH BY HEIMO AGA

sitions rather than putting money into hedge funds—a good way to diversify. Abu Dhabi and Dubai have multibillion-dollar funds that are scouting for equity investments abroad. "We will see more of that," says Brad D. Bourland, chief economist at Riyadh-based Samba Financial Group, a leading Saudi bank. "This is the tip of the iceberg."

Then there's the Mideast money flowing into U.S. Treasury securities and other passive investments. U.S. government data indicate that OPEC countries held only $67 billion in Treasuries as of December. Most of that was held by the Gulf states, but it's small compared with the giant holdings of China and Japan.

The official figures, though, probably underestimate the clout of Arab money in world capital markets. According to PFC Energy, an energy consultant in Washington, the Mideast oil states hold a cumulative $1 trillion in foreign assets—stocks, bonds, government debt, real estate, and other investments. In fact, the money isn't easy to trace because unlike the oil boom of the 1970s, today's petrodollars aren't being parked in a few big American and European banks. Instead they are sprinkled around the world through an intricate network of private banks, funds, and offshore financial centers. "There's a distinct lack of hard information on where this money's going," says Mohsin S. Khan, director of the International Monetary Fund's Middle East and Central Asian department.

HOG HEAVEN Saudi Harley owners take to the streets in Jeddah

What's more, the Arab states are now major buyers of goods from Japan, China, and the rest of Asia, where they sell the bulk of their oil. So these petrodollars get recycled as Japanese yen or Chinese yuan—which the Japanese and Chinese governments convert into U.S. Treasuries. Indirectly, then, oil money is bankrolling U.S. deficit spending. Paul Donovan, a global economist for UBS Investment Bank in London, estimates that petrodollars, mostly channeled through Asia and Europe, are funding u 45% of the U.S. curren count deficit.

While these bill circulate through global money system, only have to look arc the Persian Gulf to that huge amounts c wealth are staying ir region. Fueled by th boom, local stock ma have risen anywhere over 200% to more 1,000% in the past years, despite cu sharp corrections Egypt and the Ur Arab Emirates. Imp from the U.S., Eu and Asia are soaring.

Yet in contrast to helter-skelter deve ment of the 1970s, a and better-planned dle East economy is ri shaped by a well-educ business class and ered by a youthful po tion seeking prosp "Look at the demogr ics of these nations," says Alabbar, 46, graduated from Seattle University. " all see what the outside world is all a and they dream to live like that." 65% of Saudis, for example, are 24 old or younger.

Another important difference: Go ments in the region learned harsh le when they fell into dire financial s during the lean period of low oil pric the early 1990s. They began shifting nomic policies to cut waste and room for once-tiny private sectors to jobs. Those moves created a healthy ronment in which growth could catc once oil prices took off starting in 20

Making Sure The Boom Doesn't Go Bust

Mideast oil countries are better positioned this time around

HEN: 1973-1985	NOW: 2000-2006
OMESTIC INVESTMENT	
l money overwhelmed government inistries and the private sector, leading high domestic inflation and waste.	Most Mideast oil countries have improved their purchasing and financial controls. In Saudi Arabia, Dubai, and Qatar, the private sector is playing a major role. But oil windfalls could still threaten to overheat regional economies.
REIGN INVESTMENT	
sheiks poured money into trophy sets, mostly in Europe. Kuwait later ffered losses on Spanish investments.	Despite the controversy over the Dubai Ports deal, Gulf investors are ramping up their foreign acquisitions. Europe, Asia, and Turkey are favored destinations. Money is also flowing into real estate and private-equity funds.
OBAL IMPACT	
h oil prices caused worldwide gflation and badly damaged the nomies of the developing world.	The global economy has largely shrugged off the impact of high oil prices. Growth remains healthy, and inflation is low.
LITICAL IMPACT	
e fall of the Shah's regime in Iran sed fears that the oil states would cumb to radical regimes.	Strong economic performance is helping to shore up governments, but there is still a threat of spillover from Iraq and the struggle with al Qaeda.

Data: *BusinessWeek*

real gross domestic product grew a hy 6.5% in Saudi Arabia, by far the important economy in the region. roved confidence, fear of investing in S. and Western Europe, and the mas- amounts of private capital brought e have led to an unprecedented n," says Fareed Mohamedi, chief omist at consultants PFC.

e region's governments have devel- more careful spending strategies. Saudi government, for instance, has very conservative in its budgeting, as- ng until this year that oil prices would n to $25 per barrel. Now, with $150 n or so stashed away, Riyadh plans to increase its spending by 20% this year, to about $90 billion. Capital outlays are set to nearly triple, to $33 billion.

Planning Ahead

MUCH OF THIS MONEY is earmarked for long-term projects. They include a $50 billion, five-year program to build new roads, schools, and hospitals in rural areas; a $9 billion modernization of an oil refinery at Rabigh, with Japan's Sumitomo Corp.; and $14 billion for new production-capacity expansion at Saudi Aramco, the national oil company. "The number of megaprojects with five-year time frames is so big that it ought to sustain a lot of the private sector through this decade," says Samba's Bourland. He figures the private sector will record 8% growth this year, vs. 5% for the overall Saudi economy. In the UAE, private-sector growth has been hitting double digits.

Governments have smartened up in other ways. They are tailoring their infrastructure projects to attract clusters of similar businesses, which gain from being close together. Dubai has established Internet and Media Cities—office parks wired for high-speed data transmission. Not to be outdone, the Saudis have brought in Emaar to develop a new $27 billion King Abdullah Economic City on the Red Sea coast north of Jeddah. The planners of the new metropolis envision a giant port, and manufacturing businesses including petrochemicals and pharmaceuticals. Some 30% of the equity in the project may be offered to investors on the stock exchange.

All this creates huge opportunities for U.S., European, and Asian companies. Dubai's Internet City has attracted the cream of technology companies such as Microsoft, Hewlett-Packard, and Cisco Systems. "This is a mini Silicon Valley," says Ghazi Atallah, Cisco's Dubai-based emerging-markets honcho. The Middle East represents Cisco's fastest-growing region, with double-digit annual revenue increases thanks to local telecom deregula-

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tion and the increasing sophistication of private businesses. Mideast companies are also buying a very high proportion of advanced technology like combined video streaming and data services. "In some cases [customers in the region] are leapfrogging Europe and the U.S.," Atallah adds.

Other international companies such as Fluor Corp. and Bechtel Group Inc. are likely to benefit from the frantic pace of construction, especially in the oil fields. Aircraft makers Boeing Co. and Airbus are selling squadrons of planes in the region, which is seeing the rise of fast-growing carriers like Dubai's Emirates. That airline has an astonishing $37 billion worth of planes on order, including 45 of Airbus' new A380—the biggest order placed by any airline for the double-decker megaplane. And between them, Emirates and Qatar Airways have ordered 49 Boeing 777 jetliners. "The Middle East has become one of the three big reservoirs of aircraft sales in the world," along with China and India, says Habib Fekih, president of Airbus Middle East.

Meanwhile, Nabil A. Habayeb, Dubai-based President and CEO for the Middle East and Africa for General Electric Co., says the company's orders for the region leaped by close to 80%, to $8 billion, from 2004 to 2005. Much of that is in big-ticket items like power-generation equipment and aircraft engines, as well as oil-, gas-, and water-treatment facilities. But state-of-the-art health-care equipment and even theme parks are in demand, too, says Habayeb: "The priorities are health care, education, and diversification away from an oil- and gas-based economy."

It's not just the big U.S. manufacturers that are benefiting. International investment bankers are being called in to raise capital for regional corporations interested in taking advantage of the red-hot markets. Saudi Arabia's Prince Alwaleed raised $397 million on Feb. 23 for his Kingdom Hotel Investments, which will be listed on the new Dubai Internation nancial Exchange and in London. "" is a big backlog of IPOs," says May N lah, head of Middle East investment ing at Morgan Stanley in London, managed the Kingdom IPO. Among expected, according to bankers, are fering by Alwaleed's main vehicle, dom Holdings, and a listing of Sho

Middle East Stocks Are On A Tear

Fueled by the oil boom, stock indexes have soared since 2002

ABU DHABI
ABU DHABI SECURITIES INDEX
235%

DUBAI
DUBAI FINANCIAL MARKET INDEX
770%

EGYPT
CAIRO & ALEXANDRIA STOCK EXCHANGE INDEX
1047%

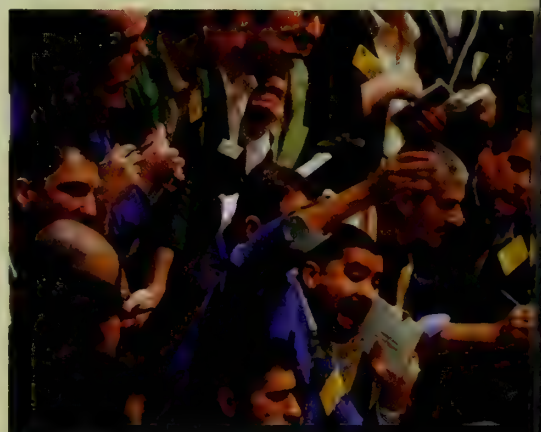
KUWAIT
KUWAIT STOCK EXCHANGE INDEX
598%

SAUDI ARABIA
TADAWUL ALL SHARE INDEX
710%

% CHANGE IN DOLLARS 2/24/02-2/26/06
Data: Bloomberg Financial Markets

OIL PRICING

DON'T UNDERESTIMATE THE FEAR FACTOR



REACTION New York traders after the Abqaiq incident

The Middle East money gusher is fed by many wellsprings, and one of them is fear. The market is justifiably worried about a massive disruption of oil supplies, possibly caused by a terrorist attack such as the unsuccessful one against the world's largest oil-processing facility at Abqaiq, in eastern Saudi Arabia, on Feb. 24. This fear is pushing oil prices higher and sending additional billions into the coffers of oil-producing nations.

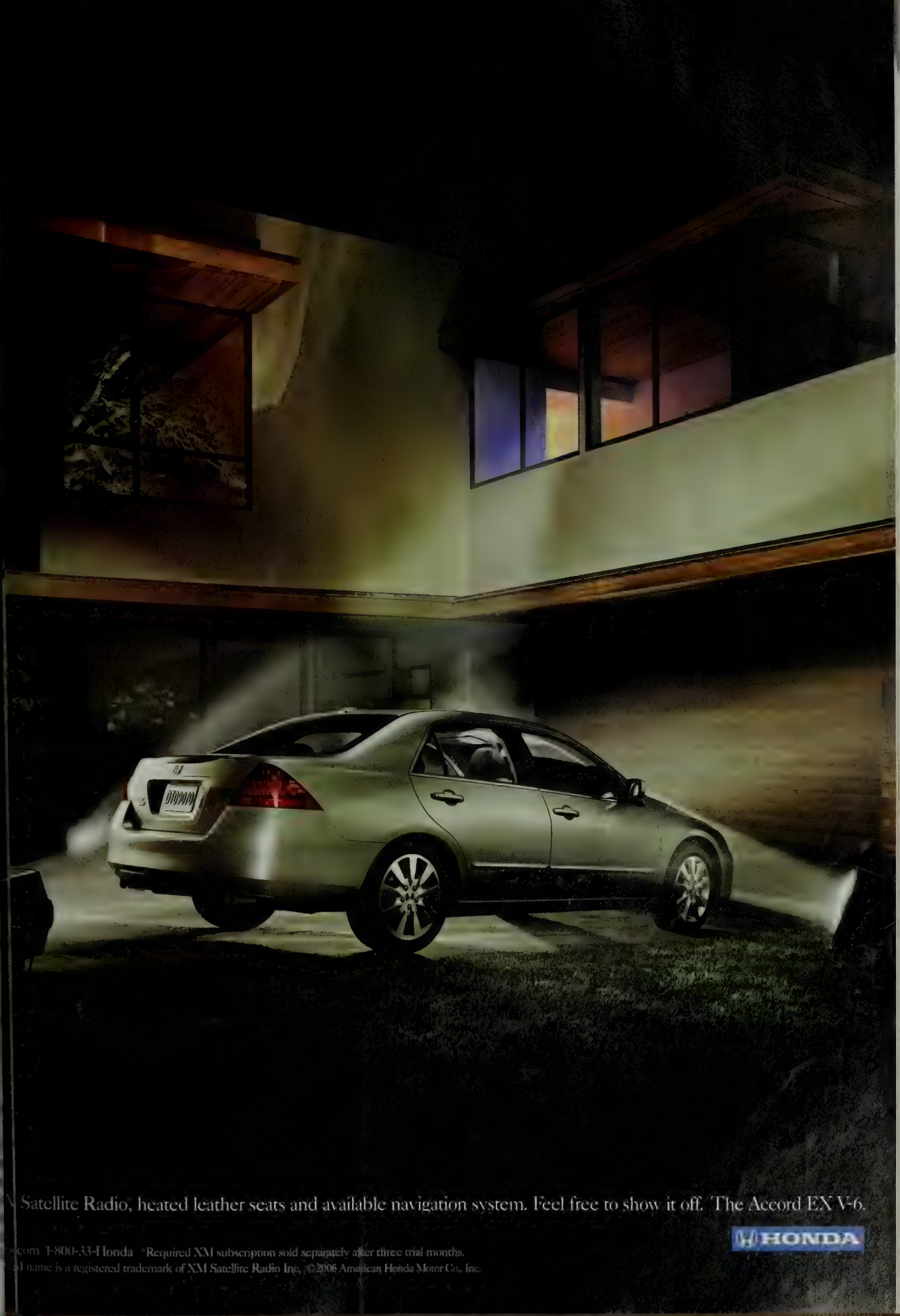
The sums involved are astonishing. According to a rough *BusinessWeek* estimate, the world paid the Persian Gulf oil states an extra $120 billion or so last year because of the premium in prices due to fear of unexpected supply disruptions.

How did we come up with that number? To get a rough handle on how the fear factor affects current oil prices, we checked with three industry experts. James W. Ritterbusch, an oil economist at Ritterbusch & Associates in Galena, Ill., says it's impossible to estimate the size of the fear factor, although he agreed there is one. Sarah Emerson, director of petroleum market analysis and research at Energy Security Analysis Inc. in Wakefield, Mass., estimates that fear adds an additional $15 to the price of each barrel of oil. Tim Evans, senior energy analyst for IFR Markets in New York, goes even higher, with an estimate of $25 to $30 a barrel.

We used Emerson's $15 "subjective guess" because her argument for it made the most sense. She argued that oil prices would be somewhat above their historical average anyway because there's little spar capacity. But, she said, prices wouldn't be this high without fears of instability: "If you said every country in this world was stable and we didn't have to worry about a disruption, I think it would get back to the $40s," she said, vs. the current price of around $60 a barrel. The $120 billion comes from multiplying that $15 premium by the annual oil exports of Algeria, Iran, Iraq, Kuwait, Libya, Qatar, Saudi Arabia, and the United Arab Emirates.

Some cynics argue that oil producers welcome the fear of disruption because it boosts their revenue. While the Saudi roy family takes pains to assure the world tha it's a reliable supplier, saber rattlers like Iranian President Mahmoud Ahmadinejad and, outside the Mideast, Venezuelan President Hugo Chávez, don't seem to mind if their threats against the West sca markets higher. Fear, says IFR's Evans, is "gift" to oil producers.

–Peter C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BUILDING UP Dubai's skylin is being transformed

Arabia, a broadcaster partly owned by Viacom Inc.

Bankers say the deal flow could really pick up if governments start to sell off their still-considerable holdings. "If governments see the opportunity to tap into this pent-up demand for financial investments and transfer ownership of public entities as the British did [under Margaret Thatcher], I think that would be very good for the market," says Osama Abbasi, co-head of the European fixed income group at Credit Suisse First Boston.

Plenty could still go wrong. Despite all the private-sector growth, the economies of Saudi Arabia and the rest of the Gulf countries are nailed to oil. Oil and gas production is more than 50% of GDP in Qatar and Kuwait and 42% in Saudi Arabia, according to Credit Suisse. Overheating is also a concern, with investors borrowing money to chase local stocks and consumer debt growing to worrying levels in some of the Gulf countries.

The political problems around the region are far from solved. In the worst case, Iraq's troubles could spill over into conflicts between Sunni and Shiite Muslims around the region. How U.S.-Arab relations play out will also prove hugely influential in containing potential strife. The U.S. is on the receiving end of a lot of criticism now, mostly aimed at its conduct of the war in Iraq. Should the U.S. withdraw, though, the Gulf states might find themselves once again under pressure from their bigger, poorer neighbors, Iraq and Iran.

Despite private-sector growth, oil still rules the region's economies

But if the Gulf regimes need the U.S., the opposite is just as true. America needs a stable source of oil for itself and the world, and U.S. companies dearly want to increase an already booming trade with the Mideast. The indirect but powerful role these oil states play in financing the U.S. deficit further enmeshes Washington's interests with the region's, no matter how contentious relations may get over America's foreign policy.

These factors increase the challenge Washington faces in encouraging reform. The authoritarian governments in the Gulf will have to change to keep pace with their wealthy, better-educated populations. They have a long way to go on improving opportunities for women, for instance. While more money in people's pockets buys time, the rulers are facing demands for greater accountability and wider political participation. Some ness people even think that oil m could have negative consequences. W nancial pressure off, governments m more likely to delay privatization and er reforms.

Yet it doesn't look like this Gulf l will fizzle anytime soon, since oil is in demand. One possible scenario: As g interest rates rise with the recove Japan and Europe, worldwide compe for capital will heat up, and the well-b investors of the Mideast will becom otal players in future deals. Oil mo role, then, could just get bigger. ■

–With Peter Coy, John Cady, and Brady in New York, Christopher Paln Los Angeles, and Carol Matlack in

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Getting the Deal Done: How to avoid the pitfalls in Washington.

Then and Now: A comparison of petrodollar flows in the 1970s and toc

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SMALL CAPS

A SMALL WORLD AFTER ALL

Are large-cap returns really due to pull ahead? Don't bet on it

BY AARON PRESSMAN

FOR THE PAST SIX YEARS returns on small caps—companies typically worth less than $3 billion—have handily beaten those of large caps. And for much of that time, Wall Street strategists have been predicting that the situation would reverse itself. But the Russell 2000 index of small-cap stocks trounced the large-cap Standard & Poor's 500-stock index by 19 percentage points in 2003 and eight points in 2004, and eked out a third-of-a point win in 2005.

Surely 2006 will be the year that the big guys—companies like DuPont and Coca-Cola Co. with market values of more than $10 billion—will beat small fry such as Rambus and Buffalo Wild Wings, right? The chorus has gotten even louder in recent months, with International Strategy & Investment Group Inc., an independent research outfit that caters to institutional investors, proclaiming on Feb. 27 that mega-cap U.S. stocks (companies worth more than $40 billion) are the cheapest asset class in the developed world.

So far, the small-cap skeptics have been wrong yet again. Through the end of February the Russell had a total return of 8.7%, while the S&P gained 2.9% (chart). Projecting those two-month results over a year, small caps would outperform large caps by around 35 points in 2006.

But the doubters aren't giving in. Beyond the basic argument that what goes up must come down, big-cap boosters cite several factors that will bring the Chihuahuas to heel this year. Before the rally, small caps traded at a price-to-earnings ratio less than that of large caps, a historical anomaly that presented a huge opportunity as big-cap tech stocks crumbled. But today the Russell is once again pricier based on p-e (table).

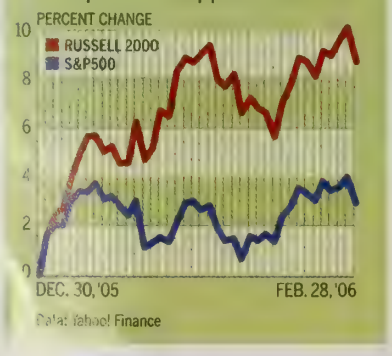
FLAWED ASSUMPTION

WHAT'S MORE, say large-cap boosters, rising short-term interest rates will squeeze smaller companies that rely on short-term bank loans for financing. And with economic growth in the U.S. slowing and overseas economies heating up, big companies will derive significant portions of their revenue abroad, while small ones, as a group, won't. "All of the dynamics in the economy are favoring large caps," says David Reilly, director of portfolio strategy at Rydex Investments in Rockville, Md.

But don't be surprised if the experts are wrong again. The Federal Reserve has signaled that it's nearing the end of its rate hikes. And with the fed funds rate at 4.5%, short-term rates remain at historically low levels.

SURPRISING THE SKEPTICS

The much prophesied small-cap slump hasn't happened in 2006



Small companies are still able to b
easily and cheaply. "The market loo
a year ahead," says Husam H.
manager of the TCW Small Cap G
Fund, "and when it sees the Fed
ping, small-cap stocks will get a pc

The assumption that large
should outperform in the next few
simply because they haven't in the p
may be flawed. Morgan Stanley con
small- and large-cap stocks going b
1926 and found that small caps ha
performed by an average of 2.4 poi
nually over every 10-year period. I
the powerful large-cap rallies in the
and 1990s, the big stocks defied th
term average, outperforming by as
as five points annually over certain
spans. Only over the past 10 year
small-cap returns drawn even wit
of large caps. They're still below t
torical average. "The pendulur
swung so far to the large-cap side
Michael Arone, portfolio manager
Street Global Advisors. "Small ca
outperform for a very long period."

Many of the factors behind sma
run are still in place. These com
have reported stronger profit gr
trend that may accelerate this y
the fourth quarter of 2005, sm
earnings rose about three point

ın profits among large caps; that gap ɔrojected to widen to eight points by e fourth quarter of this year. And ıch of the cash that's swelling the ffers of big companies—and lever-ed buyout firms—is being used to quire smaller companies. That ɔuld keep small caps percolating, some analysts.

CKING TRACTION

THE SAME TIME, the largest com-ıies are finding it hard to keep grow-. Many of the biggest stocks are ıeap for a reason," says UBS strate-Thomas Doerflinger. Giants such as rosoft, Coca-Cola, and Dell have be-ıe so big that it's almost impossible them to increase revenues at the s of yore. Doerflinger points out, for ance, that Wal-Mart Stores Inc.'s an-l sales increase is about half of ish rival Tesco PLC's total sales. No ıder growth seekers are choosing the ıller company. Moreover, regulators class action lawyers have increas-y taken on big banks, insurers, and r companies, diverting money and ıagement time from growth oppor-ties. All of which explains why large s can't get any lasting traction. The actually beat the Russell by 0.55 ıt in February and outperformed it 7 of the 36 months from 2003 to 5. But its wins are smaller, and its es, bigger.

nd, anyway, what's wrong with the ıs quo? Morgan Stanley has found since 1926, large caps returned an age of 7% a year when they were ing small caps, but 13% when they e trailing. Given that fact, does any-really want a large-cap rally? ■

Small Wonders

After six years of beating large caps, small caps look pricier based on the e-earnings ratio, but cheaper based on book value and revenues

	S&P 500	RUSSELL 2000
r-to-date return	3%	9%
-year return	6	15
-year return	3	55
ing p-e	18	40
ward p-e	15	26
e/book	2.8	2.6
e/sales	1.5	1.2

Bloomberg Financial Markets

STOCKS

REALITY CHECK FOR THE GOOGLE BOYS

The company that shrugged off the Street's demands may be changing its tune

BY MARA DER HOVANESIAN AND SARAH LACY

GOOGLE FOUNDERS Sergey Brin and Larry Page pride themselves on flouting convention. They bypassed investment bankers when they first issued shares in August, 2004. Just days before the stock's debut, they drew regulators' ire by giving an interview to *Playboy*, which violated so-called quiet rules. And they made it a formal company policy not to issue financial targets, which almost every public company does quarterly. Investors didn't seem to care: The stock soared to $471 on Jan. 11 from $85 at the initial public offering.

Now the Google boys may have to swallow their pride and start striking a more cooperative stance with Wall Street. The company lost $10.8 billion in market capitalization in just 20 minutes on the morning of Feb. 28, after Google Inc. Finance Chief George Reyes said at an investor conference that the company's growth rates were slowing. The stock rebounded slightly later in the day but still closed down 7%, and almost 25% off the Jan. 11 high. "When the stock is going up, people are less inclined to ask questions," says Scott Kessler, an equity analyst at Standard & Poor's.

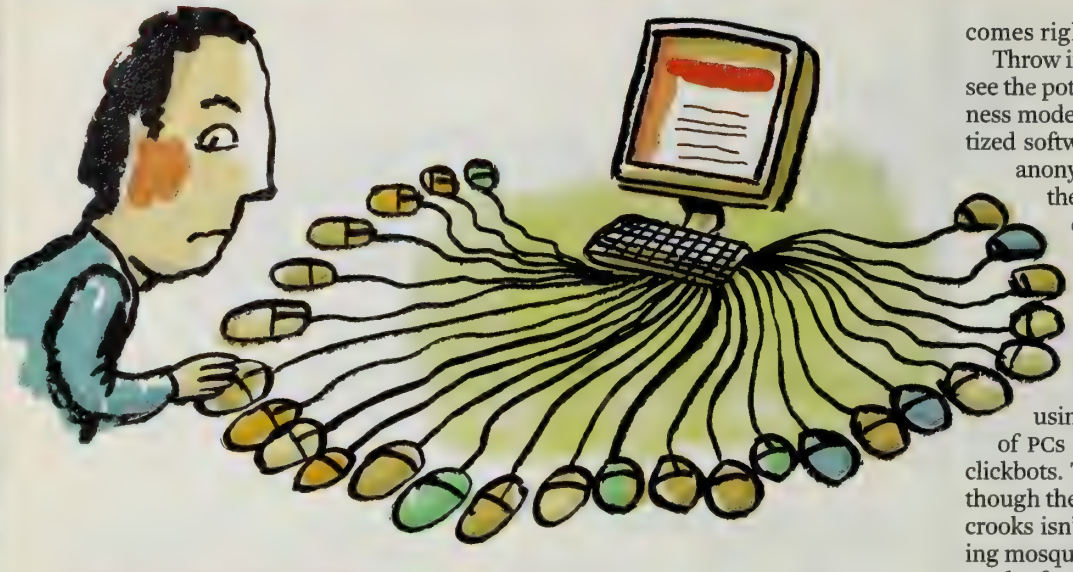
They're not afraid to ask questions now. "You have to wonder, is the first quarter going to be softer than people are expecting, and are they trying to manage those expectations?" says Martin Pyykkonen of San Francisco investment bank Hoefer & Arnett. Although Google issued a press release later on Feb. 28 that clarified Reyes' remarks, it gave no financial projections. Investors weren't satisfied; the following day the stock gained back less than a percent.

UNDERESTIMATED TAX BILL

THE SMART MONEY is wondering if Google has the financial sophistication of similar media companies its size. In January it missed analysts' fourth-quarter earnings expectations. The bulk of the shortfall stemmed from Google's badly underestimated 2005 tax bill. The miscalculation itself wasn't the only thing that rankled analysts. They thought the company should have given a heads-up. "A public company should either give the owners of the company information or live in a world in which it has a discount," says Scott W. Devitt of St. Louis investment bank Stifel, Nicolaus & Co.

PAGE AND BRIN They recently hired Google's first investor relations manager

Google may be trying to change its stripes: It recently hired its first investor-relations manager. A truce with the Establishment, however, doesn't guarantee stock stability. As investors debate the future of the search engine business and the merits of Google's investments, some big investors are starting to lose faith in what had been an easy money maker. ■



INTERNET CROOKS

HOW DO YOU CLOCK THE CLICKS?

Web advertisers have a growing problem: Scammers who charge for fake traffic

BY BURT HELM

EVER SINCE SEARCH ADS took flight, advertisers have been in a quandary. How do they determine whether the people clicking on their ads are real customers or fraudsters looking to game the system? Many companies, which pay Google Inc. et al each time someone clicks on an ad, figured that so long as search ads were generating enough measurable sales, "click fraud" was simply a cost of doing business.

Now advertisers are taking a second look. Why? Because click-fraud artists have figured out how to siphon off ad revenues from the bogus clicks without attracting much attention. What's more, these guys are starting to automate. So while no one knows how much illicit clicking is going on, it's a safe bet that the scourge may well grow exponentially.

Google, Yahoo! Inc., and other search firms say they have a handle on the problem. But although they reimburse clients for some bogus click charges, they won't say exactly how they determine what's fake. That has advertisers increasingly wondering if the industry is sufficiently dedicated to combating click fraud.

Seeing an opening, a range of companies are looking to help advertisers sort out good clicks from bad. One is credit-card fraud-detection specialist Fair Isaac Corp., which is launching a major study of the click-fraud phenomenon. "Losses due to click fraud could equal more than $1 billion [a year]," says Kandathil Jacob, Fair Isaac's product marketing chief. "It's worth our effort to look at it."

The most pernicious fraudsters set up bogus Web sites, contracting with Google, say, to place search ads on them, then artificially drive up the number of clicks. Google pays Web sites a portion of the per-click revenue. When a fraudulent Web site has hundreds of pages with up to three ads on each one, that adds up to mucho dinero—which comes right out of advertisers' pock

Throw in automation, and you begi see the potential danger to Google's b ness model. Some scammers using rc tized software called "clickbots" em anonymous "proxy" servers to cr the illusion that visitors from over the world are clicking ads. Search firms can figure whether phony visitors a work by seeing which cl come from anonymous Ir net addresses.

But now the bad guys using viruses to hijack thousa of PCs and create whole network clickbots. That way they make it loo though the traffic is legit. Detecting t crooks isn't so easy. "They're bloods ing mosquitoes," says Ken Dunham, works for the Web-security intellig firm VeriSign iDefense. "You just can' them all."

USING CROOKS' TOOLS

COMPANIES THAT crack the prob could make a lot of money. Fair I which analyzes 85% of U.S. credit- transactions for fraud, is angling to vide similar services to search firms advertisers. To start with, Fair Isa teaming up with respected search sultant Alchemist Media Inc. to pul gether advertising-traffic data. With in hand, Fair Isaac hopes to develop to track and foil the crooks.

Others are employing the scam technology to see how well Google other search firms track fake clicks. consultant Greg Boser is using click to drive traffic to clients' search ads idea: jack up the clicks, then com that number with the sum Google burses advertisers for bogus traffic one has any idea how much of this i ing on," says Boser. "We're going t how well [the search engines] pr advertisers."

Google and Yahoo they're on the case. To click fraud, they Web traffic for rep clicks, unusual patt and visits from anony servers. "Click [fraud serious but manag challenge," claims Slade, Yahoo's s director of product ma ment. The questio whether the search co nies can stay far en ahead of the click scam to satisfy advertisers.

THE STAT

40%

Proportion of advertisers who claim they've been victims of click fraud

Data: Search Engine Marketing Professional Organization

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CYBERSPORTS

MARCH MADNESS: CBS'S KILLER APP

Its Webcast of the NCAA tournament could turn the corner for video on the Net

BY TIMOTHY J. MULLANEY

MELISSA ABERNATHY is no girlie basketball fan. When her North Carolina Tar Heels aren't on the tube near her home in Hoboken, N.J., she drives as far as Richmond, Va., to watch a game. So she perked up when she heard about CBS Sports's plan for live Internet broadcasts of games from the National Collegiate Athletic Assn.'s men's basketball tournament this month. "I'm going to [sign up] right now," she says.

She may have lots of company. CBS Corp. hopes to draw millions with March Madness on Demand, the first-ever free Webcast of the tournament. It works like this: Fans register at NCAASports.com, run by CBS's SportsLine unit, then watch games live on the site. They'll have their choice of any game except for the one being broadcast by the local CBS affiliate. (CBS determines which game to black out based on the location of the computer being used.) Fans can also watch games after they're played or view highlights and other features. The live Webcasts will continue until the tournament is down to eight teams. "We'll get several million people," predicts Larry S. Kramer, president of CBS Digital Media. "It wouldn't surprise me to get the audience they get on TV, but stretched out."

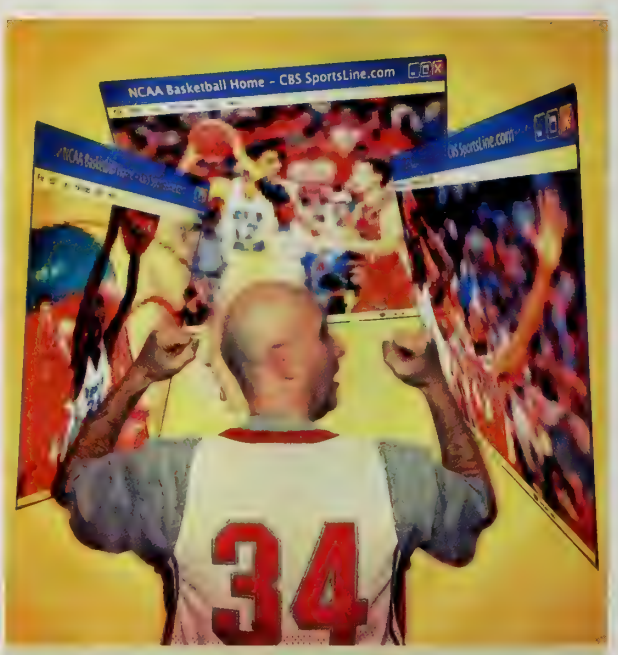
Sports events have been shown on the Net in the past, by CBS, ESPN, and others. But the audiences have been limited, since they typically cost viewers money or are niche events. The madness this March could be a turning point. Since the Webcast will be paid for with advertising, it could draw the biggest online viewership ever. Live 8, a series of 10 worldwide benefit concerts broadcast on Time Warner Inc.'s AOL Music portal last July, holds the record, with 5 million same-day viewers.

The tournament could also showcase how the Internet can provide a better experience than television, in some ways. In the first four days, from Mar. 16-19, as many as four games are played at a time. While TV viewers have to watch whatever game the local CBS affiliate sho Net viewers get more control and cho They can follow their favorite t wherever it plays or switch betw games when the action flags. They even pop open three windows and w a trio of games at once. Jeff Lan Vice-President and general manage ad agency Avenue A/Razorfish, says tournament could be like comedian ton Berle's pathbreaking televi shows, which brought mass audienc TV beginning in 1948.

Advertisers are intrigued. CBS ha sponsors for the Webcast, led by Dell Courtyard by Marriott. Deborah Fe senior vice-president at Marriott In national Inc., says the audience is fu potential business t elers, since college ketball draws so m young and middle-a men. Dell figures a V cast is a smart wa nab tech enthusi likely to buy its hig end computers. The line ads will help make money from 11-year, $6 billion d signed for the N tournament rights 1999.

One of CBS's bi challenges will be t liver high-quality online. To mini problems, CBS req people to register w name, e-mail adc and other informa Those who sign u Mar. 15 will get earl cess to Webcasts. I site is too busy on day to let everyone v at once without cra the system, lateco will have to wait other fans log off.

That's not CBS's innovative move. first-round games through the workd Mar. 16-17, its softw designed to let p view games while keeping bosses knowing who's goofing off. Click o video player's "boss button" a spreadsheet pops on-screen. "Not recommend watching during hours, but I understand that peopl deadpans Sean McManus, preside CBS News & Sports. ■



A Sports Bar at Your Desk

Why CBS is betting that its new model will be a slam-dunk

BETTER THAN TV With television, you see only the game shown in your area. Online, you can watch three at once.

MASS MARKET CBS expects up to 5 million viewers—as many as AOL's Live 8 concert Webcast drew in July.

ADVERTISER INTEREST Attracted by March Madness' affluent male audience, 20 advertisers have signed up.

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acked by BMW
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RICHARD S. DUNHAM

Spittoons and Quills But No Laptops, Please

CK IN 1914, Representative Allan Walsh of New Jersey had a revtionary idea. Walsh, an electrical engineer by training, sugsted that the House allow its members to vote electronically. s plan was referred to the House Rules Committee—and ied for 56 years. The House entered the 20th century in 1970 n it unveiled a newfangled computer-system for voting. Across the Capitol, ever, the Senate stubbornly clings s 18th century sensibilities. And those owed traditions do not include ern technology.

hich brings us to Senator Mike Enzi. Wyoming Republican was an account-shoe store owner, and computer proimer before he won a Senate seat in . A former Eagle Scout dubbed "Cyber tor" because of his proud geek status, saw no reason why he shouldn't be ald to carry his laptop to the Senate floor at he could study the issues at hand or nunicate with his staff during lengthy tes. After all, 35 states de PCs in their chamfor lawmakers. But this U.S. Senate, where the Committee informed rt Enzi that any meical devices that "dis interrupt, or inconven" members are strictly *ten.* Enzi's laptop d violate both Senate um and traditions.

e Senate's Luddite aph extends to other ar with serious conseces. Senators and their nents don't have to file aign contribution re electronically, a requirement for all federal candidates. "It is almost imble to get timely disclosure from Senmpaigns," says Carol Darr, director of eorge Washington University Instior Politics, Democracy & the Internet. ot just technophobia. It's deliberate." n security can't trump the rules. After mber 11, every member of Congress ssued a BlackBerry for instant comation in emergencies. But if a senator is seen using one inside the chamber, he or she can be written up for a rules violation.

Thumbing on the Sly

THE SENATE reasons that John Adams didn't use a laptop, so neither should Mike Enzi. Quill pens, inkwells, and starched wigs are permitted. But a cell phone, a pager, or, heaven forbid, a laptop could get a lawmaker ejected. "It's the same reason we have spittoons and snuff boxes in the chamber," says Senate historian Donald Ritchie. "There's a veneration of the way the chamber has always operated."

A decade after his arrival, Enzi, 62, is still fighting an uphill battle. While he can flaunt his laptop at committee hearings, he wants Internet access at his desk on the floor. "BlackBerrys have dramatically increased our communication abilities, but laptops have more data storage, allow the user to type faster, and information is easier to read," he says. "The more information you are able to access on the floor, the more time you can spend listening to the debate."

WIRED: Enzi's fight for Net access in the Senate faces wide resistance

The rules persist even as senators are increasingly wired. Many have embraced PDAs and PCs. "These items have become indispensable for many senators, especially when their time is double- and triple-booked," says Patrick Ross, a senior fellow at the Progress & Freedom Foundation. Indeed, Ross says, some senators have been sighted "discreetly checking their BlackBerrys" during debate.

One day that kind of guilty pleasure might be legal. But Enzi shouldn't hold his breath. "When the Senate gets around to allowing laptops," laughs historian Ritchie, "laptops will be obsolete." ■

CAPITAL INSIDER

MAD ABOUT JUNK FAXES? CALL CONGRESS

IF YOU DON'T like those ads spewing out of your fax machine, you'll have to call the feds. A U.S. District Court judge in California on Feb. 27 overturned a state ban on unsolicited faxes. The court found that the 2005 California law interfered with interstate commerce and was superseded by a federal law that bars junk faxes but allows solicitations sent by companies that have a previous business relationship with the recipient.

Business groups had fought to overturn the California law. Companies argued that the cost of screening out faxes to the Golden State would be cumbersome and expensive. Bottom line: Businesses prefer one federal law to a patchwork of state rules.

LOOK WHO'S USING WIKI TO REWRITE HISTORY

WHAT DOES the CIA have against Bill Clinton? In the latest episode of virtual vandalism by federal employees, CIA staffers have been caught altering entries in Wikipedia, an online encyclopedia that can be edited by anyone with an Internet connection. Someone using an agency computer changed Wiki's Clinton entry to note that the ex-President was "dumber" than his GOP predecessors. Spooks aren't the only ones playing dirty tricks. Wiki reports that computer users at the Justice Dept., Marine Corps, and Navy have politicized entries in recent weeks. Earlier this year, Wikipedia blocked Capitol Hill access to the site after lawmaker entries were subjected to political spin and fabrications. Wikipedia founder Jimmy Wales calls the shenanigans "routine."

NIKE Vietnam is its bigge supplier after China

BREAKTHROUGHS

GOOD MORNING, VIETNAM

Intel's deal to build a factory is likely to spur more Western investment

BY FREDERIK BALFOUR

MANY AMERICANS remember Vietnam's Reunification Palace from film clips of North Vietnamese tanks bashing through its wrought-iron gates to end the Vietnam War 31 years ago. On Feb. 28 a leading warrior of Big Business, Intel Corp. Chairman Craig R. Barrett, crashed the same gates—albeit without damage—to mark one of capitalism's most significant advances in Vietnam in decades. On that day, Vietnamese Deputy Prime Minister Nguyen Tan Dung presented Barrett with a $605 million investment license to build a new factory in Ho Chi Minh City.

The deal is the largest American investment in Vietnam ever by a non-oil company. Intel initially will spend $300 million for a test-and-assembly plant that will be finished next year and eventually employ 1,200 workers. Barrett says Intel chose Vietnam over China, Malaysia, or the Philippines because of the country's lower costs for skilled workers and its booming economy, which grew 8.5% last year. Says Barrett: "Cost is always a driving factor."

Others see Intel's decision as a vote of confidence in Vietnam as an alternative to China. Until now, the bulk of foreign manufacturing investment has been in simple assembly for the l of Nike Inc. and Lim Brands Inc. Nike's subc tractors employ 130, people in Vietnam—mal the country Nike's secc largest supplier after na—and many big te manufacturers have se shop as well. Now, Viet is breaking out of the tech box. The Intel deal very important step for nam," says Henry Ngu who runs IDG Ventures nam, a $100 million that invests in startups.

Intel isn't the only cor ny stepping in. In Febr Canon Inc. announced it spending $110 million o ink jet printer factory near Hanoi. N Corp. of Japan plans to build two plan make electronic components, at a total of $940 million. Fujitsu Ltd. has inve $200 million and employs 3,200 pe making circuit boards for PCs and ph Virginia-based utility AES Corp. is ne ating to build a 1,000-megawatt p plant in the northern province of Q Ninh that could cost as much as $1 bi And Cisco Systems, Nortel Networks Motorola are installing telecom equipr

Vietnam hasn't generated this ki investment interest since the U.S. l its economic embargo in 1994. Last approved foreign direct investm jumped 41%, to $5.8 billion, whi China the total actually fell slightly. China still saw commitments of $6 lion, but as a percentage of gross do tic product, Vietnam's total was than twice what China got last year

A big reason fo change is rock-bo wages. As labor shor in some regions of C drive up costs, fa hands in parts of mainland can earn than five times the $5 month that Vietna workers in foreign-o factories are paid. differential is a big r why Sparton Cor Jackson, Mich., Vietnam over Chin year when it made it investment outside l

THE STAT

41%

Increase in approved foreign direct investment in Vietnam last year, to $5.8 billion

Data: Ministry of Planning & Investment (Vietnam)

ıerica. It sank $8 million into a 000-square-foot plant to produce ·mical diagnostic equipment. "I ık productivity and quality will far eed the U.S.," says Jason Craft, naging director of Sparton sub- iary Spartronics Vietnam Co.

NING THE CLUB?

ERE'S MORE TO Vietnam's story n just cheap workers, though. The st expensive land for factories costs y slightly more than half what Chi- priciest areas do, and shipping n Ho Chi Minh City (the former gon) is about 6% to 8% cheaper than n Thailand or Indonesia (though htly more than rates from Shen- n, China). More important, Vietnam rs corporations an alternative loca- in the event their operations in na get shut down. "Companies t flexibility in supply lines and don't t to put all their eggs in the China ket," says Michael W. Marine, the U.S. Ambassador to Vietnam.

nam spent illion oads ports

And Vietnam this year might wrap up negotiations for World Trade Organization membership. That would be a huge boon if the results of the 2001 U.S.-Vietnam Bilateral Trade Agreement are any- g to go by. Vietnamese exports to the have increased more than sixfold r the deal, to $6.6 billion last year. hat can happen with one country, ine what could happen with 100 or under WTO," says Shankar anathan, country manager at Proc- Gamble Co., which has invested than $80 million in Vietnam since and manufactures Tide detergent other products there.

e euphoria makes some observers us. Back in the mid-'90s, foreign in- rs stampeded into Vietnam when ountry was hyped as the next big Tiger, only to be foiled by Viet- s rampant corruption, red tape, ue laws, and tattered infrastructure. ıgs have improved somewhat, gh, as Vietnam has streamlined its o meet WTO requirements and has more than $1 billion improving its and airports in recent years. That s more foot soldiers of capitalism oon be breaching the gates of Re- ation Palace. ■

–With Hiroko Tashiro in Tokyo

MEXICO

PIGGYBANKS FULL OF PESOS

Mexico's middle class is exploding, and that's good for U.S. business

BY GERI SMITH

LUCIA JIMENEZ AND Benjamín Macias have been married for just a month, but they're already buying their first home: a newly built two-bedroom bungalow in an attractive subdivision a half-hour's drive from Mexico City. Lucia, 23, a clothing store clerk, and Benjamín, 24, an office worker at an eyeglass retailer, have a combined income of nearly $650 a month, enough to qualify for a 30-year loan to buy their $25,200 house. "Before, it was much more difficult to buy your own home," says Lucia. "Things have gotten a lot better."

CASTILLO, COLORES Homeownership is at a record high

American conceptions of Mexico usually focus on the country's poverty and the endless flow of illegal immigrants to the U.S. But another Mexico is starting to emerge: a middle-class nation where millions have access to mortgages, solid jobs provide security, and a class of strivers saves to put its kids through college (page 52). This has the makings of a much more stable Mexico, and a much more lucrative market for U.S. companies. "We're very interested in the Mexican middle class," says Edmundo Vallejo, chief executive of GE Latin America, a big provider of consumer finance.

The ranks of that middle class, or those making between $7,200 and $50,000 a year, have swelled to record levels of around 10 million families. That's equal to nearly 40% of all Mexican households, vs. 30% just a few years ago. It helps that for almost a decade now, wages have been rising faster than inflation. In addition, women are having fewer children, and more of them are joining the workforce, giving households more money to spend and save.

Homeownership is the other key factor in Mexico's transformation, because it allows families to build equity, establish credit histories, and move up the economic ladder. The country is in the grips of a housing boom that is reminiscent of America's post-World War II expansion. A record 560,000 new mortgage-financed homes were built last year, almost double the number in 2000, and 750,000 more are expected for 2006.

This is a huge change from Mexico's recent history, when a series of economic crises caused the middle class to shrink. Over 25 years, steep currency devaluations periodically sent inflation and interest rates soaring, wiping out Mexicans' purchasing power and forcing

many to default on their mortgages and other debt. Even after the peso stabilized, banks refused to make home loans, and consumers had to spend years amassing the cash to buy a home.

But annual inflation is down to 3% now, and interest rates have been falling steadily. Rates on 20-year fixed-rate mortgages are 9% a year. To Mexicans who just two years ago faced rates of 18%, that's a huge improvement. Banks big and small are tripping over one another to offer mortgages.

U.S. companies are in the thick of the action. "We are seeing brutal competition among the banks," says Juan Lerdo de Tejada, consumer assets director for Citigroup-owned Banamex, Mexico's second-largest bank. That's great for consumers as rival banks lower their rates, but it's also giving Banamex plenty of opportunities. Banamex' mortgage portfolio is set to hit $2 billion by the end of 2006, from just $100 million three years ago.

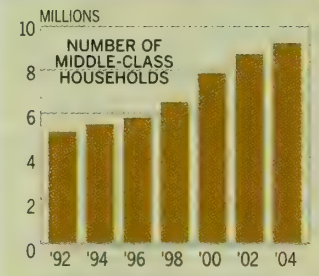
BRACKET CLIMBERS

IT'S NOT JUST mainstream banks that are cashing in on the lending boom. General Electric Co.'s consumer finance unit has its eye not only on the 10 million families considered solidly middle class but also on those migrating from working-class status to a higher income bracket. To reach them, it has opened 194 storefront GE Money outlets around the country that offer cash loans from $100 to $1,100, credit cards, auto loans, insurance policies, and even home mortgages. GE also administers the credit-card program for Wal-Mart de México, the nation's biggest retailer, and for most other department stores.

The current wealth of Mexicans surprises even a savvy player like GE. "We recently introduced mortgages for vacation homes at beach resorts and thought most of our customers would be Americans," says Farouk Salim, general director of GE Money in Mexico. "But a year ago we started seeing the Mexican middle class buying [these] second homes." Mexico is now among the top 10 countries in the world for GE's consumer finance business, and Salim says it should move into the top five within three years.

As rates continue to fall, Mexicans are buying more than homes. A record million cars and small trucks were last year, up 33% from the year 2 with Ford, General Motors, and Dair Chrysler accounting for half of all s Smaller-ticket items are flying ofl shelves. "Sales of home appliances tripled in the las years," notes Er Cervera, director Grupo de Economis Asociados, a think in Mexico City. "W buying all those 37 TVs at Sam's Club middle class." Th even money left ov small luxuries like ets to sporting e and concerts. In M City and Mont 140,768 tickets fo recent U2 concerts, prices ranging from $10 to $220, sol in less than five hours. "There is mor posable income nowadays," says J Zevada, chief financial officer of C ración Interamericana de Entretenir to, a Mexico City events and conce ganizer. Normal stuff north of the bo but a major change in a country tha endured so many crises. ■

MEXICO'S EXPANDING MIDDLE



Data: Grupo de Economistas y Asociados

EDUCATION

Learning Is Earning

Antonio Villa, 57, a chauffeur with an eighth-grade education, sacrificed heavily to send his two children to private high schools and universities, often spending more than half of his $15,000 annual salary on tuition and books. But it has been worth it: His son, Marco Antonio, 25, earned a degree in systems engineering from UNITEC, a private university, and now works for a foreign-owned bank, while his daughter, Erika, 21, is studying law at another private college, Universidad del Valle de México (UVM). "My wife and I always pushed our kids to do well at their studies so they could be successful and find good jobs," says Villa.

A university education increasingly is seen as essential for young Mexicans, so much so that university enrollment has doubled, to more than 2.4 million, over the past 15 years. Private universities quadrupled their enrollment to nearly 1 million over the same period. "Next to buying a house, the highest aspiration of the middle class is for their children to have a university degree," says UVM Chief Operating Officer Ralf Peters.

UVM is a surprising example of how Mexicans' rising hopes are benefiting U.S. business. The for-profit UVM is owned by Laureate International Universities, a Baltimore-based outfit that runs a network of 24 for-profit universities in 15 countries. 2005, Laureate logged profits of $85.7 million on revenues of $875.5 million.

Mexico is Laureate's biggest operation, with 67,000 students on 21 campuses around the country. "We are totally centere on the middle class," says Peters. Tuition is around $4,000 a year, a fraction of the $9,000-plus that Mexico's elite institutions charge. UVM specializes in practical caree majors, from business administration to health science and law. Fluency in English is a requirement for graduation. Pete says around 60% of his alums la a job within six months.

Mexico has tuition-free public universities and technical institutes, too, but they can't kee up with demand. Says recent UV graduate, Liliana Cruz: "The competition is growing because we're all struggling toward the same goal: having a decent lifestyle."

MADE IN USA UVM is American-owned

P3 WARS

ONY'S iPOD ASSAULT S NO THREAT TO APPLE

ne new digital Walkman is a step in the ght direction, but its features fall short

KENJI HALL

T MIGHT HAVE BEEN A COINCIdence, but it still must have hurt. Sony Corp. last fall booked a Tokyo nightclub for the unveiling of its latest Walkman music players. But halfway around the globe in San Francisco, just hours before Sony ed on the strobe lights, Apple puter Inc. introduced the busi-card-sized iPod nano. Al-gh the nano isn't aimed at pre- the same market as the new man, many saw the confluence of s as deeply symbolic: Here was the ese electronics giant that had pio-d the portable market 26 ago taking yet er body blow in a hat it should have nated.

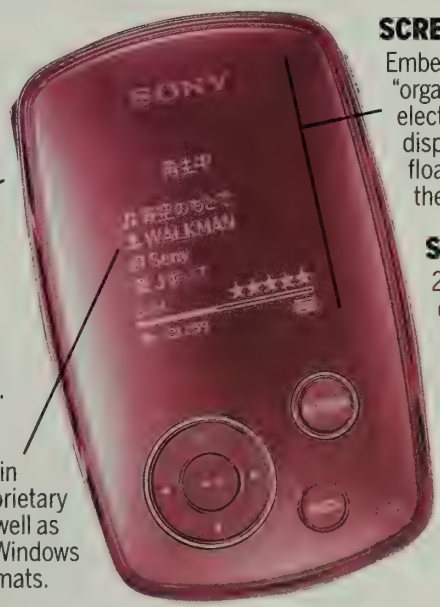
day, although iPod l kicking the stuff-out of Walkman, s offering is finally ng up a decent fight. uary, Apple had 45% Japanese market for l music players, vs. or Sony. That's a mod-mprovement for the ese company, from the 11% split a month before ew Walkman hit store s, according to research CN Ranking.

y is hoping the new machine will he company find its groove. This , Sony plans to introduce the new nan in the U.S., though execs de-o give any details of the launch. The models, with disk drives ranging 6 to 20 gigabytes, would broaden lineup in the U.S. To date, the com-has offered only players that use flash memory, with a storage capacity of 1 GB or less. Those have trailed the iPod—which has 74% of the U.S. market, compared with Sony's 2%—and even offerings from smaller rivals such as SanDisk, Creative Technology, and iriver, according to researcher NPD Intellect.

For Sony, this is no routine makeover.

iPod Lite

Sony is betting that its new Walkman can help it gain ground lost to Apple's MP3 players



ARTIST LINK Artificial-intelligence function that analyzes the songs stored on your machine and offers suggestions of similar artists you might like.

AUDIO Plays tunes in Sony's proprietary format as well as MP3 and Windows audio formats.

SCREEN Embedded 2-inch "organic electroluminescent" display appears to float on the front of the machine.

STORAGE 20-gigabyte hard drive stores 5,000-plus songs.

BATTERY The Li-ion cell powers the Walkman for as long as 30 hours between charges.

In September, Sir Howard Stringer, Sony's new chief, declared the player one of the company's main "weapons against commoditization." To break the new Walkman out of commodity status, Yujin Morisawa, a designer who was just three years old when the original Walkman came out in 1979, sketched a curvaceous shell that looks something like a smooth river stone. "I thought, 'How can I give shape to the music?'" Morisawa says. Other team members brainstormed new ways to organize music and came up with an "Artist Link" button, which analyzes your music tastes and suggests new artists you might like, and a "Time Machine Shuffle," which plays only music from a given year.

"YOU HAVE TO MATCH APPLE"

SONY IS ATTACKING Apple in Japan with its Mora online music store as well. With some popular songs from its record label's vast catalog, Sony bypasses iTunes and sells them only on Mora. That encourages many Japanese pop fans to opt for a Walkman instead of an iPod, because Sony's machine is better integrated with the site. In December the site sold 1 million songs, nearly triple the total of a year earlier.

Still, the new Walkman has some serious disadvantages. About the size of a deck of cards, the $280 NW-A3000 Walkman is bigger than the $300 iPod, but it offers just 20 GB of storage space (enough for about 5,000 songs) compared with the Apple machine's 30 GB. And Sony's Connect music site in the U.S. is no match for Apple's user-friendly iTunes software and music store. "The new Walkman is better than what Sony had before, but I don't think that many people are going to go out and buy one," says Ming-Kai Cheng, an analyst at brokerage CLSA. And with the latest iPods offering video, the music-only Walkman has more catching up to do. By 2007, predicts researcher iSuppli Corp., 55% of all music players will also show video, up from 5% last year. "Video is now standard because Apple includes it," says iSuppli analyst Chris Crotty. "You have to match Apple, at least, to compete."

The iPod's elegant click-wheel, simple software, and countless adapters to plug into a car or home stereo have helped give Apple an edge, too. In 2005, Apple shipped more than 32 million iPods worldwide, says researcher Gartner Dataquest—seven times Sony's forecast for the Walkman for its fiscal year ending Mar. 31. Facing numbers like that, even a distant No. 2 might well be considered a victory for Sony. ■

Do I Deserve a Wedgie?

My Feb. 13 economics cover story provoked a lively, ongoing Web discussic

BY MICHAEL MANDEL

Imagine throwing a rock down into a deep well and listening hard for the faint splash. That's how I used to feel when I wrote a story back in the dark ages of the 1990s. Aside from a smattering of letters, I had no way of gauging reader reaction or even knowing whether my articles were being read at all.

Things have changed—oh, have they changed. The well of isolation has turned into a rushing waterfall of online comments, discussion, thoughtful criticism, and attacks on my knowledge of economics. From my perspective, at least, it's all for the better.

Case in point: the response to my Feb. 13 cover story, "Unmasking the economy," in which I argue that official government statistics mismeasure the knowledge economy. In particular, I outlined why business investment is higher than the official numbers show due to the fact that spending on intangibles such as R&D and product development is not picked up in gross domestic product. Moreover, savings is higher than conventionally calculated, and the trade deficit omits what Harvard University economist Ricardo Hausmann has called "dark matter," the net export of American business knowhow and other unmeasured intangibles.

The cover inspired a wide variety of positive and negative reactions. Representative Rahm Emanuel (D-Ill.), chairman of the Democratic Congressiona Campaign Committee, sent a letter to his congressional colleagues urging them to r the story. Emanuel's goal: to build support for a nonpartisan commission to study

INTANGIBLE INVESTMENTS

"The government's decades-old system of number collection and crunching captures investments in equipment, buildings, and software, but for the most part misses the growing portion of GDP that is generating the cool, game-changing ideas."

"Unmasking the economy"

Economic-evaluation measures are lagging reality in the economy. Badly. This landmark article supports that idea with incredible clarity and eye-popping statistical support.

–Tom Peters, www.tompeters.com

Brand equity, training? Anyone who has worked in a corporate environment can really tell you how "useful" some of these expenditures truly are.

–Alexander Chiu, commenting on www.rgemonitor.com/blog/setser/

The notion of using intangibles to calculate GDP has been around for some time. And most economists believe it is a bad idea because such numbers are inherently unreliable. They are *intangibles*—unknowns. To allow subjective analysis to seep into our GDP statistics would be, in effect, to Enron-ize the national account.

–Gal Beckerman, www.cjrdaily.org

What BW fails to grasp is that most people aren't thinking about the economy; I'm not sure if all that many people even have an opinion on the macro issues. But they do have a sense of their own financial situation: Are they getting ahead, are they falling behind, is thei standard of living rising or falling, how much confidence do they about the future, etc. On that score, much of the country has beco increasingly pessimistic.

–Barry Ritholtz, bigpicture.typepad.com

Seeing that Mike Mandel and Chris Farrell are two of the aut goes a long way in understanding what it's about....
Both of these guys are so far out of touch with Main Street—one these days some laid-off worker is going to give both of them a w

–Tim Iacono, commenting on bigpicture.typepad.com

SAVINGS

"Calling things by their right names has clear advantages. Persisting in the fiction that governmer and household spending on R&D, training, and education is only consumption is to misunderstand the knowledge economy."

"Unmasking the economy"

I don't know if these measurement shortcomings mask an American savings rate that, in fact, is much higher than it is conventionally believed to be. Maybe; maybe not. But I do k that these problems reviewed by Mandel are important eno to cause you to pause before you panic at the next report of Americans' low, low, low rate of savings.

–Don Boudreaux, cafehayek.typepad.com

ssible improvements to the
nomic statistics.
By contrast, a week after the
sinessWeek cover appeared, *New*
k Times op-ed columnist Paul
gman disapprovingly wrote,
nout mentioning names: "Some
ple insist that the U.S. economy
hidden savings that official
istics fail to mention."
he story has provoked
sionate, ongoing discussions on
inessWeek Online; on my blog,
nomics Unbound; and on other
nomics sites. When I printed out
ne online comments and posts
ng to do with the cover, I ended
vith a stack of about 200 pages,
ost a small book.
didn't do an exact count, but my sense is
the remarks and posts, taken all together,
unning roughly two to one against the
y. Plenty of people were complimentary,
a larger number had strong negative
ions about the article. "Voodoo

The comments and posts amount to some 200 printed pages, a small book

economics," "lame," "extremely misleading," and "naive" were some of the adjectives they used to describe it. "Are you joking?" one person wrote in a comment. "C'mon, dude, I was beginning to think you were smarter than the typical journalist."

Many criticisms and comments, however, raised interesting questions. I have been addressing them on my own blog and will continue to do so.

Rather than leaving the entire conversation online, my editors asked me to bring selections from it to our print readers. Below are selected blog posts and comments on the three main themes of the story: intangibles, savings, and dark matter. Given the limited amount of space here, I tried to represent a range of responses—the good, the bad, and the ugly.

Still, these excerpts only scratch the surface of the discussion. If you want to dive deeper, go to my blog. There you'll find links to every post mentioned below, plus many more places where the story's themes are being talked about.

This is an experiment. Tell us whether bringing a Web discussion into the magazine works, and, if so, what we can do better next time. And if you have more thoughts about the economy, bring 'em on.

---

eople insist that the U.S. economy has hidden savings that statistics fail to capture. I won't go into the technical debate nese claims, some of which resemble arguments used not o to justify dot-com stock prices, except to say that the osely one looks at the facts, the less plausible the "don't e happy" hypothesis looks.

rugman, The New York Times, *Feb. 13*

an economist, but it seems to me that one problem ndel's argument is that we're not investing in human Government spending on universities has been , leading to huge increases in tuition and much greater s on individuals and families.

a Allen, commenting on delong.typepad.com

MATTER

> The same intangible investments not counted in GDP, such as business knowhow and brand equity, are for the most part left of foreign trade stats, too. [Ricardo smann, director of Harvard's er for International Development,] ibes these cross-border flows of how as 'dark matter.' "
>
> *sking the economy"*

no doubt that the U.S. does better exporting les than exporting tangibles. But that is a low bar for a country that imports twice as many tangible goods as it exports.
The only question is, does it all add up. I suspect not.

–Brad Setser, www.rgemonitor.com/blog/setser/

I don't see how it matters who the debt is to, if the money is well spent. If the education spending is worthwhile (which it may not be, of course), then the U.S. should welcome Chinese investments into our education. The fact that the individual getting the education has to pay back some of their future earnings to Chinese creditors, as opposed to American creditors, won't really matter to them.

–Joseph Weisenthal, www.thestalwart.com

Assuming that "dark matter" does exist, and that it exists here and not in a galaxy far away (where it probably does exist), one may raise a question [about] who will be paid for that dark matter. How will dark matter impact the income and lifestyle of the bottom 80% of Americans?

–Piotr Berman, commenting on delong.typepad.com

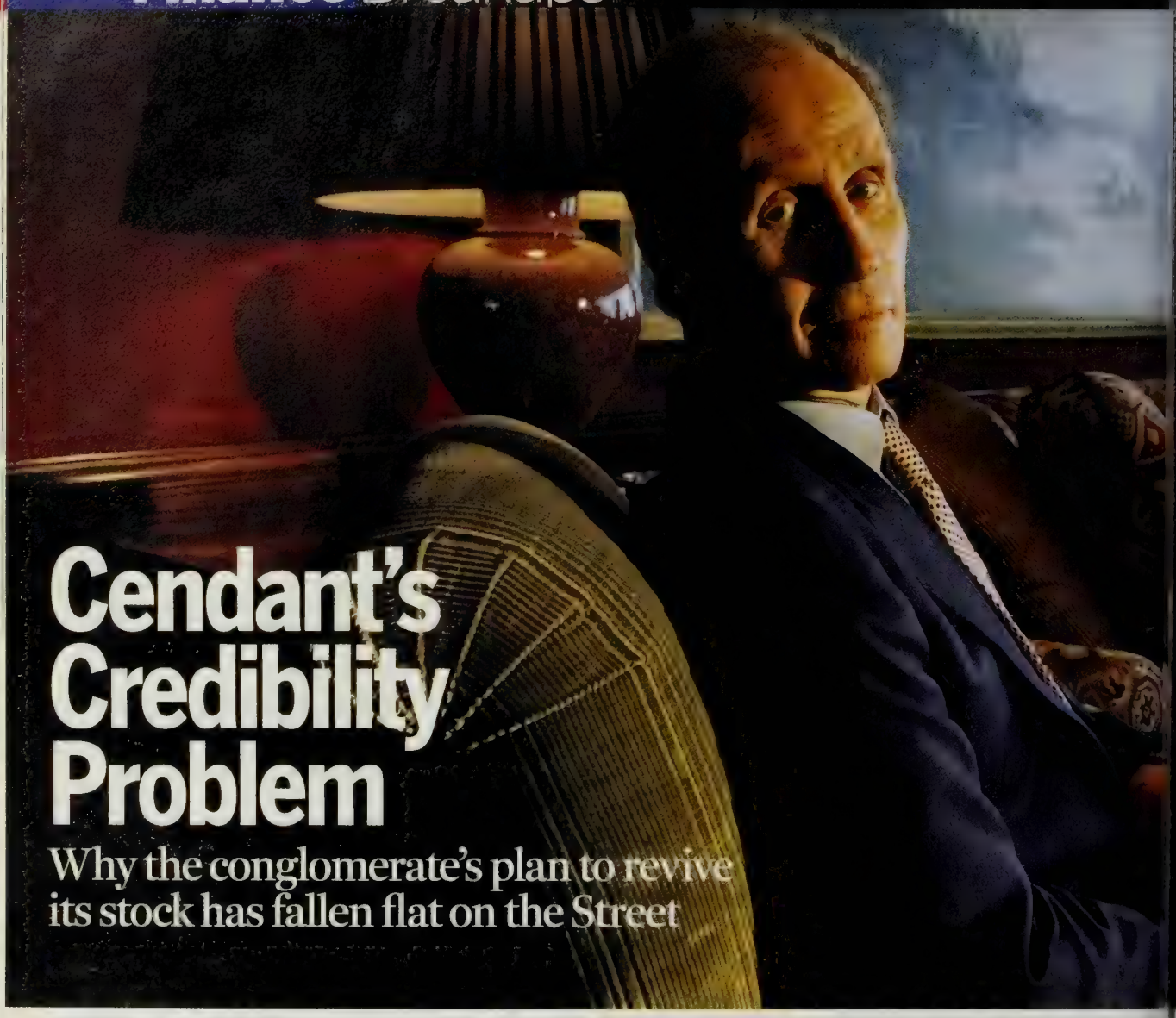
The theory is clearly delusional bubble thinking, but it's so new that economists haven't had time to assimilate it and show exactly why it's delusional bubble thinking.

–Walt Pohl, commenting on delong.typepad.com

BusinessWeek online The Feb. 13, 2006, cover story "Unmasking the economy" and reader comments can be found online at www.businessweek.com/magazine/content/06_07/b3971001.htm.

To join in the conversation on intangibles, savings, and dark matter, go to Michael Mandel's blog Economics Unbound at www.businessweek.com/the_thread/economicsunbound/

In addition, the blog provides links to the other economics sites mentioned in this story.



Cendant's Credibility Problem

Why the conglomerate's plan to revive its stock has fallen flat on the Street

BY ROBEN FARZAD AND AMY BARRETT

WALL STREET ANALYSTS have been saying for years that travel and real estate conglomerate Cendant Corp. is undervalued. And for years it has only gotten cheaper. A 46% gap now separates Cendant's stock price from analysts' average price target, the widest of all of the companies in the Standard & Poor's 500-stock index, according to Bloomberg.

To bridge the chasm, Cendant announced in October that it will break up into four separately traded units: hospitality, real estate, travel distribution, and vehicle rental. Said Chief Executive Henry R. Silverman in the press release announcing the breakup: "The market has not fully recognized the value of the company.... We and our advisers believe the sum of the parts has a value in excess of our current share price."

Investors believe otherwise. Since the breakup plan was announced, Cendant's shares slumped by as much as 19%, to around 15, a multiyear low.

Why the vote of no confidence? Management's credibility is declining by the day. If the stock's slide continues, Cendant might find relief only outside the public capital markets. "Going vate," says analyst Carol Levenso GimmeCredit, a New York-based research firm, "could be an increasi attractive alternative."

To be sure, Cendant, a growth-b quisitions success story until it me with a company riddled with accou fraud in 1997, is dirt cheap by se measures. According to Thomson Fi cial, its price-to-earnings multiple is 13, compared with industry and m multiples of 30 and 20, respectivel price-to-cash-flow ratio stands at arou third that of rivals and of the broad m And this for a company that thre more than $2 billion in free cash last from a portfolio that includes nat brands Avis, Budget Rent A Car Sy Century 21 Real Estate, Ramada, and itz. Its valuation "cannot get much l for a company generating this kind of flow," says David M. Stamm, an anal

Management's Miscues

- Excessive CEO pay
- Botched acquisitions
- Earnings misses
- Asset writedowns
- Ineffective share buybacks

SILVERMAN The CEO's compensation is out of line with his company's poor performance

Johnson Asset Management, which holds shares.

The gap between Cendant's perceived value and the market's interpretation is baffling. Some Wall Street analysts are saying the stock price will rally at least 50% over the next year, once Cendant unlocks the supposed billions in hidden value. But traders who bet on such spreads haven't fully accepted that proposition. If the credit market believed in Silverman's rosy scenario, it would not have hiked Cendant's annual debt insurance cost by 20% in just one week in February. "There are many variables that impact the cost of credit default swaps, not the least of which is speculation in the marketplace," responded Cendant spokesman Elliot Bloom in an e-mail message to *BusinessWeek*.

Management hardly inspired confidence by issuing two earnings warnings since announcing the breakup. On releasing its fourth-quarter earnings in February, Cendant said it expected low-single-digit growth in earnings before interest, taxes, depreciation, and amortization 'DA) for 2006, far less than the pre- guidance of 10% to 12% growth.

NSIVE ACQUISITIONS

REASON for the lowered forecast? n times at Cendant's travel distribu- nd vehicle services divisions. Cen- nnounced a $425 million charge in vel distribution business, chiefly to off its disastrous $350 million pur- in 2005 of Ebookers, Europe's No. 2 Web site. In December, management anticipated a charge in the range of million to $300 million. Cendant ent more than $1 billion apiece to t Orbitz and Gullivers Travel.

llions of dollars in cash flow should een returned to shareholders," says idler, director of research at Ariel l Management LLC, which owns . Instead, the money went to expen- quisitions. The company points out 's installed new executives with substantial online-travel experience.

Cendant's real estate brokerage business also seems shaky as the housing market starts to cool. CIBC World Markets estimates that each percentage-point drop in sales volume or price in 2006 would strip a penny from Cendant's earnings per share. In the fourth quarter, notes Frank K. Lee of capital-structure research firm CreditSights, Cendant's real estate EBITDA dropped for the first time in four years. Writedowns could follow.

All of which, say doubters, is destabilizing Cendant's balance sheet. Goodwill, or the amount paid for an acquisition above the current market value, "is turning into bad will," says Lee. Excluding Cendant's assets under management—chiefly its rental car operations, which are pledged against secured debt and therefore distanced from shareholders—the company's goodwill of $12 billion at yearend 2005 actually exceeded stockholders' equity of $11.3 billion, Lee calculates. As Cendant writes down more, he explains, it is "dollar-for-dollar writing down what the company is worth." The charges, responds Bloom, "bear no relationship to the current market value of the company."

Against this backdrop sit the controversial pay packages of CEO Silverman, who founded the company's forerunner in 1990. He netted about $24 million in salary, bonus, and long-term compensation in 2004, after pocketing $23 million in 2003. For 2005, a year that saw Cendant shares fall 21%, the company awarded Silverman $22.3 million.

"People are upset at how Silverman has been paid, the performance that he has turned in," and ill-timed share buybacks, says one large investor. "The only people who lose are shareholders." Bloom disputes that Silverman is overpaid. "Henry Silverman's bonus is based on the operational performance of the company, not on the stock price," he wrote.

There is, of course, another way for Cendant to escape its troubles: the private-equity route, whether through a leveraged buyout or the piecemeal auctioning of assets to buyout firms.

Cendant is no stranger to private equity. Last year, Silverman, a former partner at New York-based Blackstone Group LP, sold the firm's marketing services division to private-equity firm Apollo Management LP.

Cendant's cash flow-centric businesses lend themselves to private-equity financial engineering. Avis and Budget, for example, could be valued richly after Hertz's $15 billion buyout last year. The recent buyouts of hotel chains La Quinta, Wyndham International, and Fairmont Hotels & Resorts cast a similar halo on the lodging operations of cendant, the world's second-largest hotel franchiser. "In hospitality and vehicles, it's a no-brainer for private equity," says Stamm. "Cendant has lower-end brands, but they generate a ton of cash flow."

Could Cendant be taken out in one fell swoop? Management half-jokingly threw out a $25 billion to $30 billion price tag in a recent conference call, well in excess of the company's total value of around $20 billion. "They obviously should entertain offers," says CreditSights' Lee. "But I don't think anyone in their right mind would spend $25 billion to $30 billion."

DESCENDANT

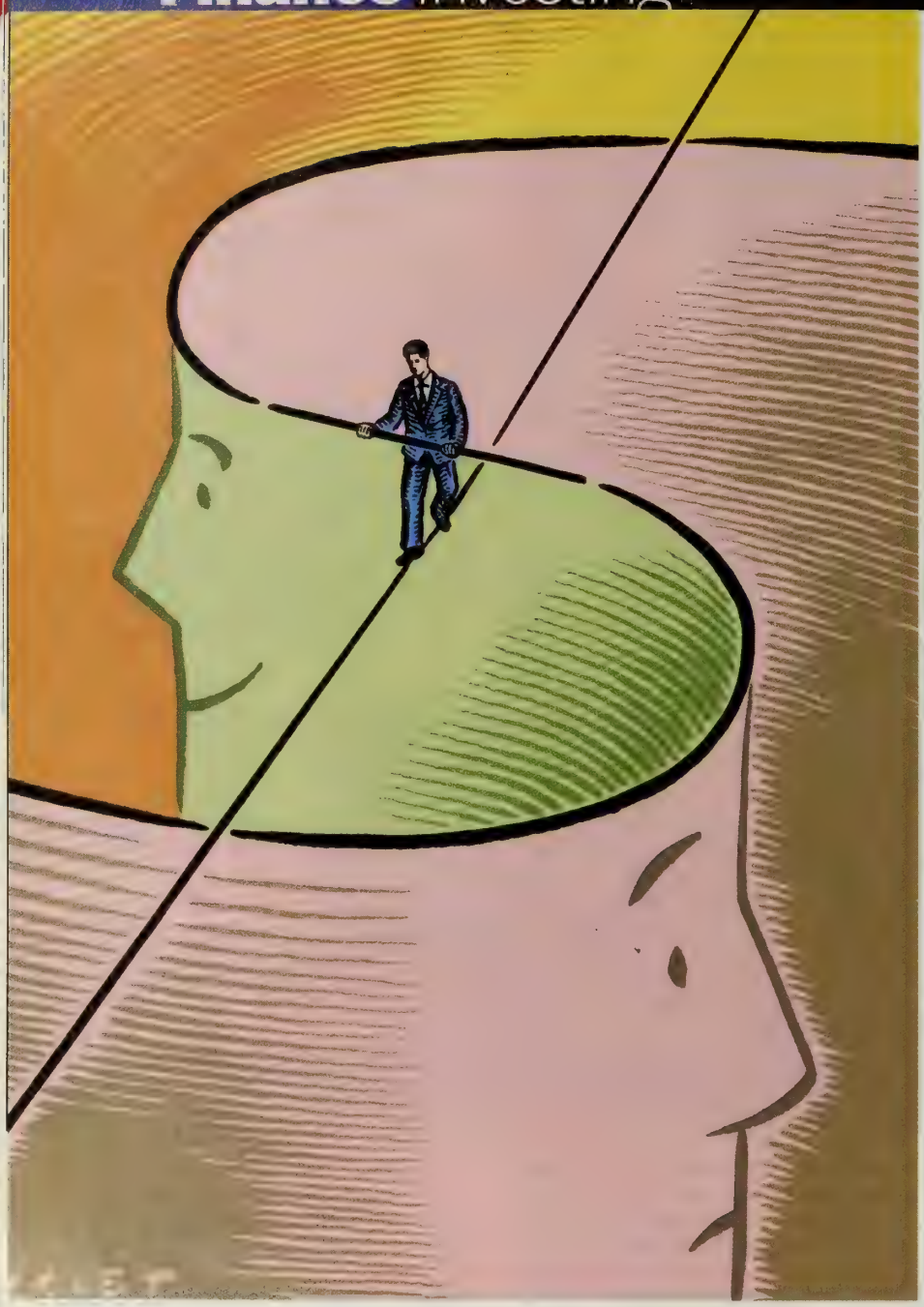
Even a bold breakup plan hasn't improved Cendant's share price

Data: Bloomberg Financial markets

They might not have to. Private-equity firms could pay only half of Cendant's hypothetical asking price if its businesses keep deteriorating. Lee says that if the real estate and travel distribution markets keep declining, the company's stock could fall an additional 30% to around $11.68, implying an enterprise value of just under $12 billion. It is, he concedes, a worst-case scenario.

That would still be a big deal by private-equity standards. But it's possible if, say, corporate buyers agreed to buy two of the businesses and private equity bought the rest—along the lines of the recent buyout of grocery chain Albertson's Inc. "I don't think size is a problem here," says Lehman Brothers Inc. tax and accounting analyst Robert Willens.

Roger C. Altman, the head of New York-based Evercore Partners Inc., which is co-advising Cendant on the breakup, dismisses the private-equity option, insisting that a buyout would be too big and that a piece-by-piece sale would be prohibitive tax-wise. He argues that the company's recent spate of bad news makes the four-way breakup plan all the more compelling for investors. "The value gain opportunity for shareholders in the split company is even larger with the stock decline," he says. Can cold comfort be written down? ■



Cross-Dressing Securities

The new debt-equity hybrids look like the best of both worlds. But are they?

BY DAVID HENRY

WITH CORPOR balance sheet healthy as ever stockholders c oring for bette turns, a big c tion for execu today is how to lever up to expand buy back shares without taking or much debt. Erin Callan, a tax-lav turned-investment-banker at Leh Brothers Inc., thinks she has the an in a new, custom-crafted variety of s rity that has Wall Street buzzing.

Known generically as enhanced t preferreds, these securities look like to investors and tax lawyers, who now, say companies can deduct the i est they pay out. Here's the thing: also look like equity to credit-rating a cies and regulators, keeping bondho happy. They're debt-equity hybrids ultimate two-faced securities. "This the potential to redefine capital struc for Corporate America," says Callan deals are expected to boost earning share and stock prices for issuers generate a ton of fees for underwrite

They're certainly innovative. Hy make regular bond-like payments t vestors. But unlike bonds, hybrids exceedingly long maturities—ofte years or more—which makes them e tially permanent capital, like e What's more, if a company's credit thiness falls below preset threshold bond-like payments automatically But that doesn't trigger a default o company's real bonds.

When times are good, hybrids off best of both words: fat yields for inve and favorable accounting treatmen companies. But when conditions ch these untested securities could offe worst of both worlds: low returns, risk, and angry investors.

Callan, 40, is among the most cre chefs, and last August her employer t her cooking. Lehman issued $300 m of hybrids at a floating interest rat deal that kicked off the market. Since other top investment banks have co ed their own variations, which they sued for themselves and underwritt clients. Citigroup brought out a $45 lion, 5.9% issue for toolmaker St Works in November, which the com used to pay for two acquisitions. M Lynch & Co. and Goldman Sachs & C a $500 million, 6.61% offering Burlington Northern Santa Fe Corp. to repay debt and fund share buybac Jan. 25, Wachovia Securities broug

gest deal to date, a $2.5 billion, 5.85% ring for its parent, Wachovia Corp. se debt-equity hybrids have evolved to ome "an unbeatable capital markets duct" for banks and insurance compa-, and might be used more in other in-tries as well, according to a report by ndard & Poor's, the debt-rating agency , like *BusinessWeek*, is owned by The Graw-Hill Companies.

T FOR THE FAINT OF HEART

BE CLEAR, hybrids are a terrible idea ndividual investors. They're complex, syncratic, and sometimes not even stered with the Securities & Ex-nge Commission.

ut institutional investors are lapping n up. The appeal: With interest rates ow in the U.S. and abroad, fixed-in-e mavens are desperate for an extra point of yield and will take the addi-al risks these untested securities g. More than 200 institutional in-ors bought into Wachovia's big offer-nearly 10 times the core group of in-ors that Wall Street had seen turn out he less sophisticated trust-preferred ids of the past. "From all indications, market is still in its cy and will grow lly this year and next year," says Hines, a managing tor and head of grade syndicate at ovia Securities.

me $8.8 billion n of hybrids have issued so far this a rate that would ce around $52 bil-of issues by nd—about 50% than last year, Callan and other tment bankers still engineering test generation of enhanced trust-reds. This year some $30 billion of revious generation of hybrids be-s eligible to be called back by the is-, primarily financial institutions. re all but certain to be refinanced he new version, which offers lower st rates, tax deductions, and new as credit-enhancing equity capital ing agencies and bank regulators, ohn W. Dickey, head of global new cts at Citigroup's investment bank. n for sophisticated investors, hy-could be dangerous. They might rove to be a product that flourishes when the economy is strong, when investors are optimistic that issuers will prosper enough to redeem the instruments. Toss in a few high-profile defaults here and there, and investors will flee to the relative safety of bonds, which have stronger claims than hybrids in bankruptcy settlements.

What's more, as noted in offering statements, the hybrids' tax-deductibility to issuers is still just a matter of opinion from tax lawyers, not a definitive ruling by the Internal Revenue Service. Ditto accounting regulators, who already have their sights on overhauling definitions of debt and equity and accounting for trusts, which are used in structuring the securities. "You're always at the risk that the referees will change their minds," says David A. Hendler, a senior analyst at CreditSights Inc., an independent research firm.

In the meantime, Wall Street is looking at huge windfalls both as issuers and as underwriters. Hendler estimates that Citigroup, Wells Fargo & Co., and Bank of America Corp. could use the hybrids to fund share buybacks that would boost their earnings per share by 5% to 8% and, ostensibly, lift their stocks. What's more, based on the 2.5% underwriting commission on the Wachovia deal, Wall Street could generate $1.2 billion in underwriting fees for selling the securities just for the 20 top U.S. banks. Rating agencies, too, would pocket fees from evaluating the new issues.

Today's hybrids have grown out of decisions by regulators going back decades and out of instruments used by companies in Europe and Asia. Last year, two big changes hit that are driving today's deals. In February, Moody's Investors Service, the debt-rating agency that had generally been the most skeptical of hybrids, issued new policies outlining when it would deem portions of an issue of hybrids to be equity. That meant companies could issue hybrids to buy back stock without hurting their credit ratings. Callan and competing investment bankers got busy engineering hybrids to meet Moody's tests for equity and IRS tests for debt expense.

Callan says she adapted elements from deals she had worked on overseas, where hybrids are more common and accepted by tax people. By August she and two other tax lawyers at Lehman had crafted the first hybrid to be issued with tax-deductible payments, terms appealing to investors, and 75% equity credit from Moody's. Other companies followed suit with similar deals.

The question is whether Callan and her competitors will be able to sell the structures to nonfinancial companies that don't constantly try to reduce their cost of money the way banks do. It has been tough so far. Most executives are reluctant to be financial pioneers, especially when they have to persuade their directors to go along. "You don't just pull these down off the shelf," says Citigroup's Dickey. "There are a lot of moving pieces." Secondary-market prices show that investors apparently have less confidence that nonfinancial issuers' hybrids will pay off as quickly as they want.

Still, money from hybrids may prove too cheap for nonfinancial companies to ignore. Callan calculates that the typical cost of hybrid capital tends to be about 4% after tax, compared with 12% for equity capital. With spreads like those, hybrids may be about to fly. ■

INNOVATOR Former tax lawyer Callan crafted a hybrid rated like an equity with a tax edge

Pays Like a Bond, Stays Like Equity

Debt or equity? More companies are selling hybrids to garner benefits from credit-rating services and the IRS.

COMPANY	DATE	HYBRIDS SOLD (MILLIONS)	MATURITY/COUPON	EQUITY CONTENT*
Burlington Northern	Dec. 12	$500	50-year/ 6.61%	75%
Stanley Works	Nov. 15	450	40-year/ 5.9%	50
U.S. Bancorp	Dec. 21	375	60-year/ 6.35%	50
Wachovia	Jan. 25	2,500	perpetual/ 5.8% fixed, then floating	75
Washington Mutual	Feb. 24	2,000	perpetual/ 7.25% and 6.5% fixed, then floating	75

*As judged by Moody's Investors Service **Data:** Lehman Brothers Inc., company reports

China, Savior of the Rust Belt?

FREEMAN: "Everywhere I go I hear the same thing: 'God, w are screwed.' "

A former U.S. trade official looks East to revive struggling auto parts makers

BY PAUL MAGNUSSON

ONLY LAST SEPTEMber, Charles W. Freeman III was one of America's top international trade negotiators. As a Mandarin-speaking lawyer in the Office of the U.S. Trade Representative, Freeman shuttled between Washington and Beijing as he wrestled over such issues as software piracy and the valuation of the yuan. On those trips, Freeman would "fly over the Midwest and wonder what was down there." These days he's finding out. His down-to-earth mission: selling China on the Rust Belt.

Now managing director of the China Alliance, a venture of three law firms—two Midwestern and one Canadian—Freeman advises clients in such cities as Detroit, Milwaukee, and St. Louis about how to tap into the $820 billion in foreign reserves that China is holding. In the process, he could help salvage some of the hundreds of small U.S. auto parts makers struggling to survive. But Freeman sees a more overarching effect. Investment in America's heartland, he argues, would strengthen Chinese ties to the U.S. and promote goodwill and influence in Washington. Eventually, China might even join Japan and South Korea as a player in the world's most lucrative auto market, he contends.

So far, Chinese companies aren't lining up for a piece of the Rust Freeman has yet to comple deal, though he claims to be to selling two Midwestern parts companies—makers brakes, heaters, and air co tioners—to Chinese investor

Freeman, 41, gained his f on China naturally: His fa was President Richard M. Ni translator on his ground-brea trip to Beijing in 1972. After g uating from Tufts, Freeman ied Mandarin at Shanghai's F University and then got a law gree at Boston University spent the next four years at a ture-capital firm in Boston b moving to Hong Kong, whe helped run the local office o San Francisco-based Asia Fou tion. Returning to the U.S., h a stint as a Capitol Hill aide, went to work for U.S. Trade resentative Robert B. Zoellick

Now his firm is tryin smooth the way for U.S. Canadian companies to products in Asia. But Free sees a more intriguing side selling companies outright. auto parts makers seem l smooth fit for Chinese inve They're small companies o type that dominate Ch manufacturing, they're in a dustry where China wan make inroads, and they're i need of capital. "Everywhere I go, l the same thing: 'God, we are screw says Freeman. "They tell me: 'This ness has been in my family for 75 and I have third-generation wo here. My own kids aren't interest taking it over, and now I don't think even stay in business.' "

NOT AN EASY SELL

WITH GEELY AUTOMOBILE CO. pla to produce an inexpensive car for th market this year and Chery Auton Co. saying it will begin exporting in Rust Belt manufacturers could pro supplier base for those Chinese auto panies or any others that eventually production in the U.S.

Still, the idea of snapping up American companies, even at fi prices, isn't an easy sell on the othe of the Pacific. "China is only at the ve

ing stage of investing in the U.S.," Todd M. Malan, president of the Orzation for International Investment, a hington lobby for U.S. subsidiaries of gn-based companies. Its count of ese members: zero. Indeed, a closely ded list of some 250 Chinese-owned panies in the U.S., compiled by the assy of the People's Republic of China ashington and obtained by *nessWeek*, features only two ily recognizable names: iance maker Haier Group, h failed in its bid last year uy Maytag, and Lenovo p, which completed its hase of IBM's PC Div. last ember.

inese manufacturers are now being officially enaged to invest in the U.S., edes Dai Yunlou, comial minister-counselor at Chinese Embassy. And a's would-be shoppers were put off ummer when a hail of protest from ol Hill helped kill China National ore Oil Corp.'s bid to purchase Calia-based Unocal Corp. Now, says nan, Chinese investors ask: Is our y welcome there?

e hesitation may be real, but Donald raszheim, president of Los Angeles omic consultants Straszheim Global ors, predicts a massive transformaust around the corner. Soon, he says, ese manufacturers "will be buying we call 'reach': logos, trademarks, l names, customer lists, sales forces, houses, advertising, technology, gerial talent, and expertise."

me U.S. cities are trying to bring on the arrival of that day. Milwaukee Mayor Tom Barrett sought Freeman's advice before taking a delegation to Ningbo, an auto manufacturing hub south of Shanghai, last October. Barrett's goals: open the Chinese market to imports of large-engine motorcycles, such as Milwaukee-made Harley-Davidsons, and attract Chinese money to Wisconsin's struggling small manufacturers. China estimates that it has half the world's motorcycles. But a third of them have noisy, smoky, two-stroke engines, more like lawnmowers than cars. Harley-Davidson, which plans to open its first dealership in China this year, figures its bigger, smoother bikes could appeal to China's upwardly mobile city dwellers.

Potential investors: Chinese carmakers with U.S. ambitions

Freeman suggested that Barrett pitch the big Harleys first to municipal police departments. Their visibility would create "enormous cachet" and help overcome the so-called safety rules against big bikes that also protect local motorcycle makers. Next, he told Barrett, "your goal should be to put the mayor of Ningbo on a Harley."

Freeman says he gives both American and Chinese companies the same counsel: "The first thing you need when deciding on foreign investment is good government relations and the support of local governments and communities." An idea being kicked around in the U.S.: building a Chinatown in Milwaukee to make investors a little more comfortable when visiting their money. ■

BIO

harles W. Freeman III

says Chinese investment in America's rtland would strengthen ties to the U.S.:

N Aug. 20, 1964.

Managing director of the China Alliance, ee-year-old firm trying to attract Chinese tment to small U.S. auto parts makers.

CATION Tufts University, BA in Asian es and economics. JD from Boston rsity.

H A HAND Father served as President ix's translator on historic 1972 trip ablishing U.S. ties with China. Freeman ed Mandarin while studying at ghai's Fudan University. He most recently was Assistant U.S. Trade Representative for China.

FAVORITE BOOK *In the Time of the Americans*, by David Fromkin.

FAVORITE FOOD *Ma po tofu*, a spicy pork and bean curd dish.

FAVORITE RELAXATION Fishing in Narragansett Bay.

ON CHINA'S CAUTIOUS INVESTMENT APPROACH "The Chinese cross the street by feeling the stones first."

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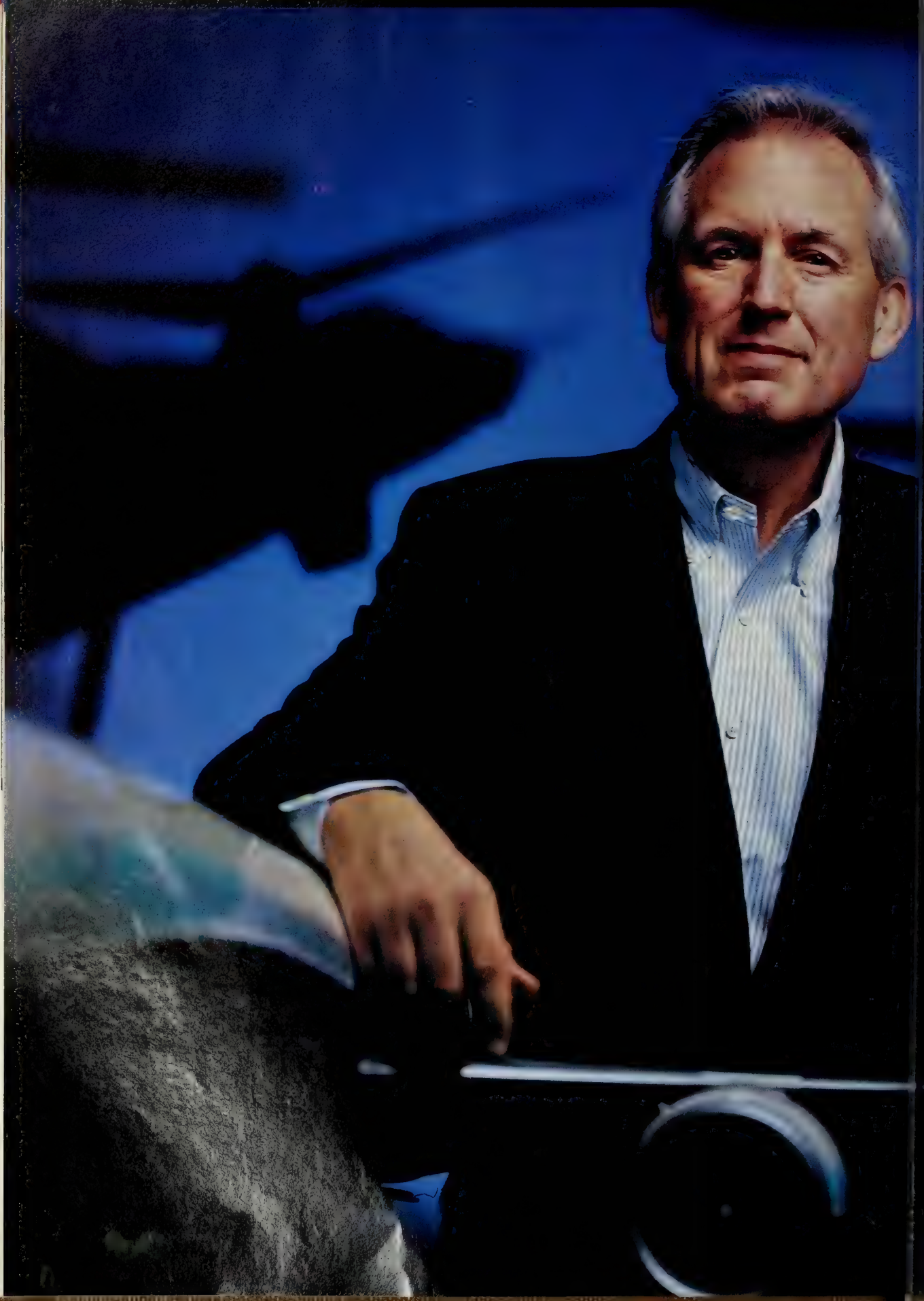

CLEANING UP BOEING

Can outsider Jim McNerney rid the scandal-plagued aerospace giant of its rot? He's off to a strong start

BY STANLEY HOLMES

WHEN W. JAMES MCNERNEY JR. decided that Boeing Co.'s top managers needed a loud wake-up call, the new chief executive chose the obvious place to sound the alarm: the company's annual executive retreat on Jan. 4 and 5. A year earlier, the event had been held at the posh Mission Hills Country Club in Palm Springs, Calif., and nobody apparently had a better time than McNerney's predecessor, Harry Stonecipher. After a day devoted largely to socializing and playing golf, the former CEO, surrounded by Boeing's elite, closed down the bar and then fired up a cigar. It was at the same event that the married Stonecipher began a relationship with a female vice-president at Boeing—a misjudgment that ultimately paved the way for his humiliating ouster on Mar. 6, and for McNerney's appointment as CEO on July 5. Stonecipher could not be reached for comment.

The "Palm Springs fling," as it became known at Boeing, marked an all-time low for the company. It followed a three-year binge of widely publicized corporate misbehavior highlighted by the jailing of Boeing's former chief financial officer for holding illegal job negotiations with a senior Pentagon official, the indictment of a manager for allegedly stealing some 25,000 pages of proprietary documents from his former employer, Lockheed Martin Corp., and the judicial finding that Boeing had abused attorney-client privilege to help cover up internal studies showing that female employees were paid less than men. Scandals involving multiple forms of misconduct in geographically scattered locations enveloped nearly every division at Boeing, leaving little doubt that the legendary company, even as it began to enjoy a cyclical boom, was plagued by a poisonous culture.

Given that backdrop, nobody was particularly shocked when the 2006 annual retreat was moved to the more quotidian Hy-

MATTHEW GILSON

att Regency in Orlando and pared from three days to one and a half. The real surprises began during a breakfast speech when the normally upbeat McNerney launched into the sharpest critique of the company he had ever aired before such a large audience. Speaking without notes, McNerney said that "management had gotten carried away with itself," that too many executives had become used to "hiding in the bureaucracy," that the company had failed to "develop the best leadership." The next day, McNerney introduced General Counsel Douglas G. Bain, who really lowered the boom, railing against Boeing's pervasive "culture of silence." To grab the group's attention, Bain rattled off the federal prison numbers of two jailed former employees. "These are not Zip Codes," Bain snapped. With McNerney looking on in clear support, Bain warned the audience that many prosecutors "believe that Boeing is rotten to the core."

The challenge of cleaning out the rot at the heart of Boeing is one for which McNerney, 56, has spent his entire professional life preparing. Since earning his master's degree from Harvard Business School in 1975, he has uprooted his family every two or three years in search of the next professional test. He started in brand marketing at Procter & Gamble Co., jumped to McKinsey & Co., and then climbed the ranks through General Electric Co. for 18 years, where he topped out as CEO of GE's aircraft engine business, one of Boeing's most important business partners. After losing in a three-way race to replace Jack Welch as CEO of GE, McNerney was snapped up by 3M Co. in 2001 to turn around the struggling manufacturer. A short time later, he joined Boeing's board.

HIGHFLIER The Renton (Wash.) factory rolls out hot-selling 737s

Straight Arrow

MCNERNEY IS A LEADER who both understands and cares about the aerospace giant. The series of ethical violations that surfaced at Boeing grated on the a straight McNerney when he was a tor, as did the fact that in 2003 the company lost its status as the w No. 1 commercial aircraft company bus. Now McNerney has what he h ways wanted: a chance to seal his at one of America's most importan panies. But to do so, he'll have to re the 153,000-employee, $55 billion sus, which, besides losing its mora pass, has not yet reached its profit-n potential. "I think the culture had phed in dysfunctional ways in places," the polished, soft-spoken M ney said in a recent conversatio *BusinessWeek*, his first extensive int since taking the job. "There are ele of our culture that I think we all like to change."

Specifically, McNerney wants to balkanized management team th been at war ever since Boeing m with McDonnell Douglas Corp. ir The distinct cultures of the two c nies never meshed, and the diffe calcified into bitter rivalries. H spent his first six months on the j "deep dive" learning about the cor McNerney believes that internal not only is at the root of the company's ethical scandals b has prevented managers from cutting costs and sharin ideas effectively. His prescription includes some predict ements, including exerting more effective central lead over Boeing's three divisions, changing the way executi paid, and encouraging managers to exploit the giant ma turer's cost-cutting leverage. But it also includes some al ones, such as encouraging managers to talk more about Boeing's severe ethical lapses. "I want to try to m O.K. to have that dialogue," says McNerney. The scan Boeing aren't "something that happened in a separate the company that half of us aren't responsible for."

If McNerney's plan succeeds, Boeing could be po

PLAYBOOK: BEST-PRACTICE IDEAS

How McNerney Is **Rebuilding** Boeing

The new CEO inherited a sprawling behemoth littered with fiefdoms. Here's how he plans to reshape

END A CULTURE OF SILENCE

In the past, Boeing execs often looked the other way when their colleagues committed serious ethical lapses to gain a business edge. Now they're expected to speak up. Compensation is linked not only to higher performance targets but also to higher ethical standards.

STOP THE BALKANIZATION

To discourage destructive internal competition and the hoarding of information, part of executives' compensation will be based on how well they share information with other units across the company. The goal is to create a common culture and work toward a shared goal.

PAY FOR REAL PERFORMANCE

Rather than base long-term executive incentive plans on a higher stock price, which doesn't take into account management's performance in the industry's inevitable downcycles, managers will now be rewarded for boosting productivity as well as driving growth over a three-year cycle.

TAKE A TEAM APPROACH

Top executives will lead te responsible for standardizin streamlining production line redundant and costly R&D centers. The aim is more consistent results, lower cos and better productivity, whet airplane assembly lines or in aerodynamics research lab.

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soar. For all of Boeing's internal dysfunctions, McNerney inherited a company that is booming. Because of a recovery in the airline industry, Boeing's commercial airplane unit notched a record 1,002 firm airplane orders in 2005, with the 737 the company's biggest seller. The division's success is best epitomized by its first new aircraft in 10 years: the lightweight 787 Dreamliner, which carries 220 passengers and burns 20% less fuel than similar-sized airplanes. Sales have soared since Boeing launched it two years ago; the company secured 379 orders and commitments from 27 airlines. And even though Boeing Integrated Defense Systems faces a decline in revenues resulting from Pentagon cutbacks, the division is positioned well in key military growth areas such as network systems.

All of this has sent Boeing's stock price up 34% over the past 12 months. But McNerney believes that his company, historically a boom-and-bust enterprise, can do better. Relentless ethical scandals and bitter infighting, he believes, have dampened the aerospace giant's performance. "If we can get the values lined up with performance, then this is an absolutely unbeatable company," says McNerney.

Rather than simply giving speeches about management virtue, insiders say that McNerney is trying to lead by example. He wins praise from co-workers for paying attention to the small things like remembering people's names, listening closely to their presentations, and not embarrassing underlings in public. That marks a sharp distinction from the blunt Stonecipher and the remote Philip M. Condit, who stepped down as CEO in 2003 in the wake of the Pentagon scandals. And it's hardly the only trast between McNerney and his predecessors. McNerney c n't travel with a big entourage or even spend much time on ing's plush 737 business jet. "Harry and Phil used to have do of handlers. Phil had a private chef on the [737] and an aide camp, but Jim mostly flies on the smaller Challenger," says a ing executive who has worked under all three leaders. Cc could not be reached for comment.

More important, McNerney asks different types of quest than Stonecipher and Condit. "Phil or Harry would get int weeds on the technical stuff," says this executive. "But Ji more interested in the human side. He is interested in how create a culture where people speak up and take the risk stop a production line because something is wrong."

Buried Secrets

THE FACT THAT STONECIPHER and Condit didn't make t kinds of inquiries could be a big reason why bad news surf so slowly at the old Boeing. Consider the story of Ken Branch, a Lockheed Martin manager who accepted a jo 1997 with McDonnell Douglas in its space rocket prog which later became a Boeing unit competing against Lockl Branch took about 25,000 pages of documents, many with prietary markings, from Lockheed Martin. About a dozen ing employees saw some of these documents over a 2½-yea

A Spate Of Scandals

The price of a 'win at all costs' culture

A BOEING DELTA IV ROCKET

FEBRUARY, 2002 Settles a ities fraud suit for $92.5 million. The suit stemmed from a 1997 attempt to produce a record number of planes; the ensuing chaos led to a $2.6 billion write-off. Plaintiffs alleged Boeing papered over the mess. Boeing didn't admit wrongdoing.

JULY, 2003 Pentagon strips Boeing of $1 billion worth of Delta rocket-launch business for possessing stolen proprietary Lockheed Martin documents. The company is suspended from doing business with the government for 20 months.

NOVEMBER, 2003 Chief Financial Officer Michael Sears is fired for offering a job to the Air Force chief acquisition officer overseeing Boeing contracts for the Pentagon.

DECEMBER, 2003 Boeing's board asks CEO Philip M. Condit (left) to resign over growing Pentagon scandal. Former Boeing president and board member Harry Stonecipher named CEO.

JANUARY, 2004 Pentagon a controversial lease deal to finance the acquisition of some $20 billion worth of Boeing refueling tankers for the Air Force.

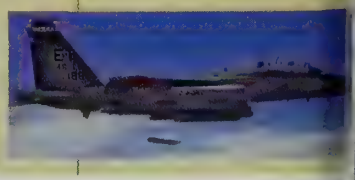
OCTOBER, 2004 Darleen Druyun (left), the Pentagon official recruited by CFO Sears, is sentenced to nine months in prison. Among other things, Druyun said she had committed the Air Force to buying the tankers from Boeing at an inflated price as a "parting gift" before her retirement.

JANUARY, 2005 Sears is sentenced to four months in prison for holding illegal job talks with Druyun. Sears also received a $250,000 fine and two years' probation. He had previously pleaded guilty to one count of aiding and abetting illegal job negotiations.

FEBRUARY, 2005 The Pentagon announces that it's investigating eight more Air Force contracts handled by Druyun, includi one involving Boeing's sma diameter bomb system (below).

MARCH, 2005 Board remo CEO Stonecipher after he h an affair with a female colleague and exchanges r messages with her over the company's e-mail system.

NOVEMBER, 2005 Boeing settles a sex-discriminatio class action for $72.5 milli The suit alleged that top company officials knowing underpaid female employe and denied them promotio according to Boeing's own documents. The company denied wrongdoing.



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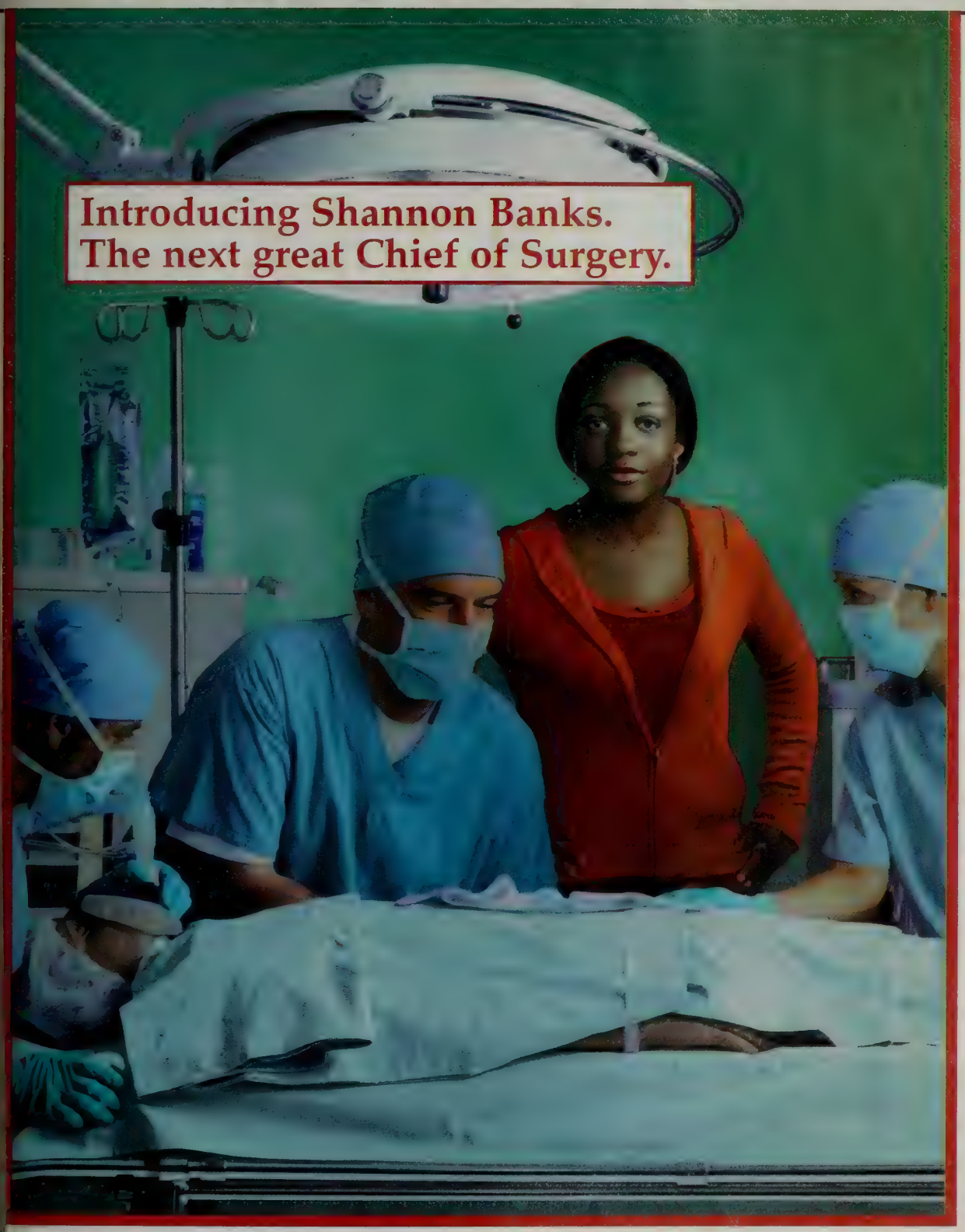

As a pre-med student studying at one of America's Historically Black Colleges and Universities (HBCU), Shannon is poised to make great contributions to medicine. A commitment to developing future leaders is why Honda sponsors HBCU programs such as the Honda Campus All-Star Challenge and Honda Battle of the Bands. Because of the important work done by these great educational institutions, young people like Shannon will one day literally save lives.

HONDA
The Power of Dreams

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riod. It was only in June, 1999, that an employee came forward. "How could you have that many documents floating around and nobody said anything?" Bain asked at his presentation in Orlando. "Was there a culture of 'win at any cost?' " If that was indeed the case, the price turned out to be incredibly high—and not just to the company's reputation. The incident cost Boeing $1 billion in government business, and Lockheed Martin is seeking up to $2 billion in damages, citing lost business.

McNerney also wants to erase an unhealthy legacy at Boeing's World Headquarters that developed in the Condit and Stonecipher eras. The corporate offices that Boeing adopted as headquarters when it moved from Seattle to Chicago in 2001 had become a hotbed of corporate infighting with executives competing for resources and recognition as the next in line for the CEO spot. Even when sales at the business units declined, costs at headquarters had continued to rise. To counteract the image of Boeing's Chicago base as some elite enclave, McNerney has changed the name from World Headquarters to "the Corporate Center." He says World Headquarters sounded "too imperial."

BYGONE ERA Stonecipher w unable to unite Boeing's warri factions

Values Overhaul

HE'S ALSO NARROWED the corporate headquarters' role to primarily supporting Boeing's two big profit-and-loss centers. Other staff functions such as legal, public relations, human resources, ethical compliance, finance, and international will be streamlined and reduced if necessary. McNerney has no plans to move corporate back to Seattle, but he wants the Chicago executive headquarters to rethink its role. "I think what happened is we got to Chicago, and then the definition of what we are was incomplete," McNerney says. "What do we do here? Do we all just live in a building? Or are we going to figure out a way to help make this company greater than the sum of its parts?"

McNerney is revamping pay to promote reform

Revamping pay is another powerful tool McNerney is using to reform Boeing's culture. In the old days, no points were awarded for collaborating with other units or following ethics rules. Now pay and bonuses are directly linked to how well executives embrace a set of six leadership attributes such as "Living Boeing Values." That includes new criteria such as promoting integrity and avoiding abusive behavior. McNerney is also giving managers financial incentives that better reflect the cyclical nature of the aerospace industry. Boeing's past long-term incentive system, called Performance Shares, paid out based on a higher stock price. But that system failed to consider management's performance during the down cycles inherent in the industry, thus offering managers few incentives to find a way to improve performance during a downturn.

McNerney also plans to take greater advantage of Boeing's economies of scale in the supply chain and to create a more efficient research and product development process. Both goals had been thwarted in the past by the company's balkanization. Consider the issue of global sourcing. Boeing currently buys 200 different kinds of safety glasses and 80 d ent shades of white paper. The defense and commercia plane divisions each negotiate for their own aluminum titanium, says James F. Albaugh, CEO of Boeing Integrate fense Systems and the executive responsible for the g sourcing initiative. "Why can't we buy two or three diff kinds of safety glasses? Why can't we have standard part bers that go across the enterprise?" he asks. "It's all about ing us one company. It will give us leverage and make u pendent on each other for success."

The job of improving Boeing's huge R&D operation fa Chief Technology Officer James M. Jamieson. He wants to out redundant lab operations and create standard engine tools. One area of focus: fixing the trouble-plagued spy sa program, Future Imagery Architecture. The program's ch design and production woes have cost Boeing hundreds o lions of dollars. Doing this will require managers to surm a formidable challenge: The satellite and airplane cultures to find a common language. "Part of Boeing talks very fl of aerodynamics," says Jamieson. "[But] the satellite talks about networks." And the satellite world tended to b each satellite was unique. "Now we are beginning to use dard tools and processes," Jamieson says. "We're beginn see real improvement in cost, schedule, and quality."

Expect to see much more of that under McNerne Jamieson observes, McNerney "looks down into the detai brings it up to a high level of strategy." He recalls how M ney once asked him to explain the benefits of the com technology being used on the 787. Jamieson started expl about the longer fatigue life of composites and the lack c rosion compared with aluminum, until McNerney stoppe "I was giving him a pure technical answer, and he was a what it means to business, the passenger, and the airl Jamieson says. "He's asking the broader questions. He h jectivity because he wasn't raised in one of our worlds."

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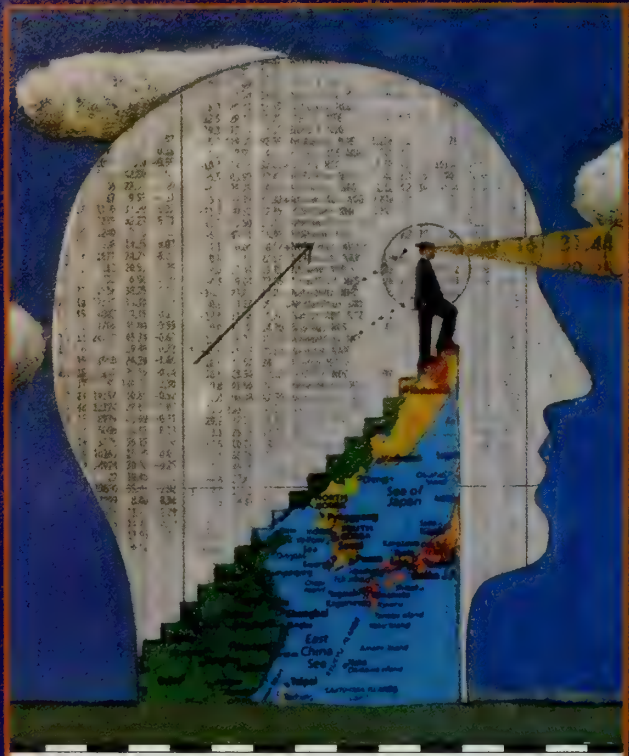

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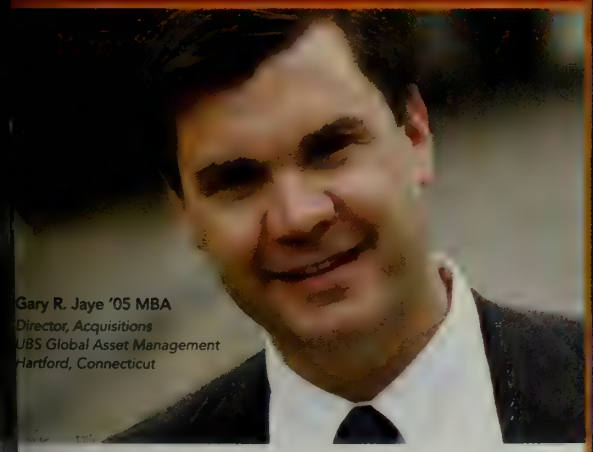

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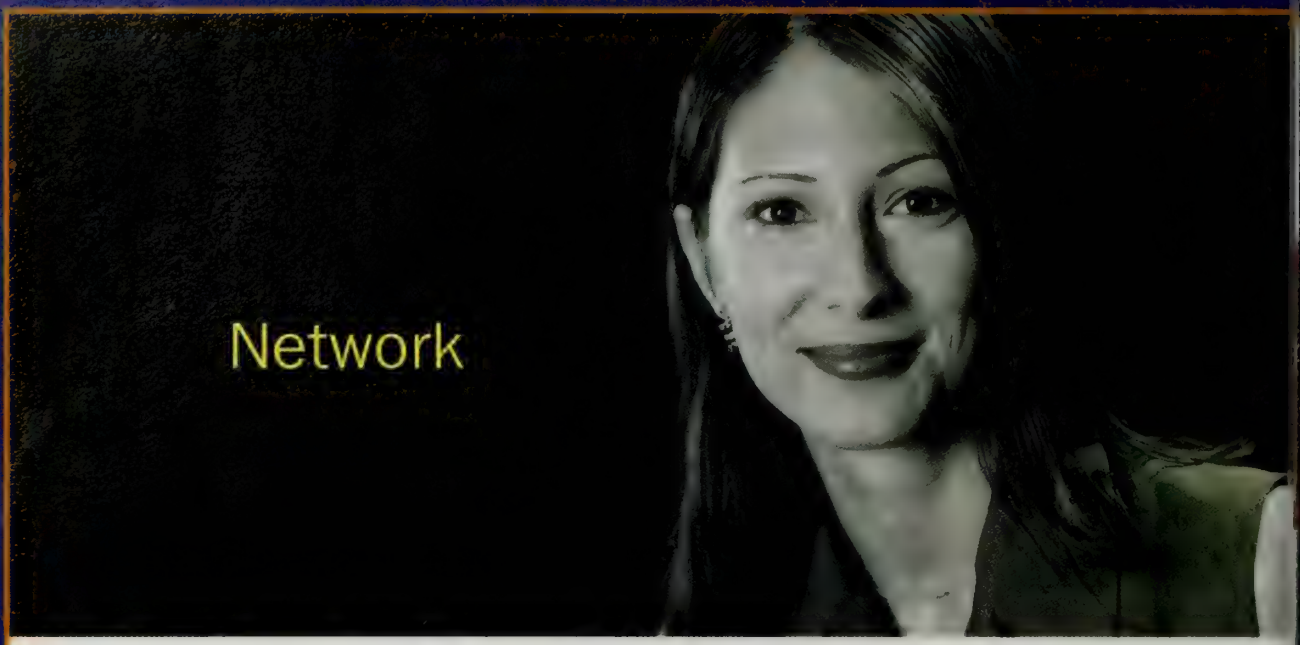

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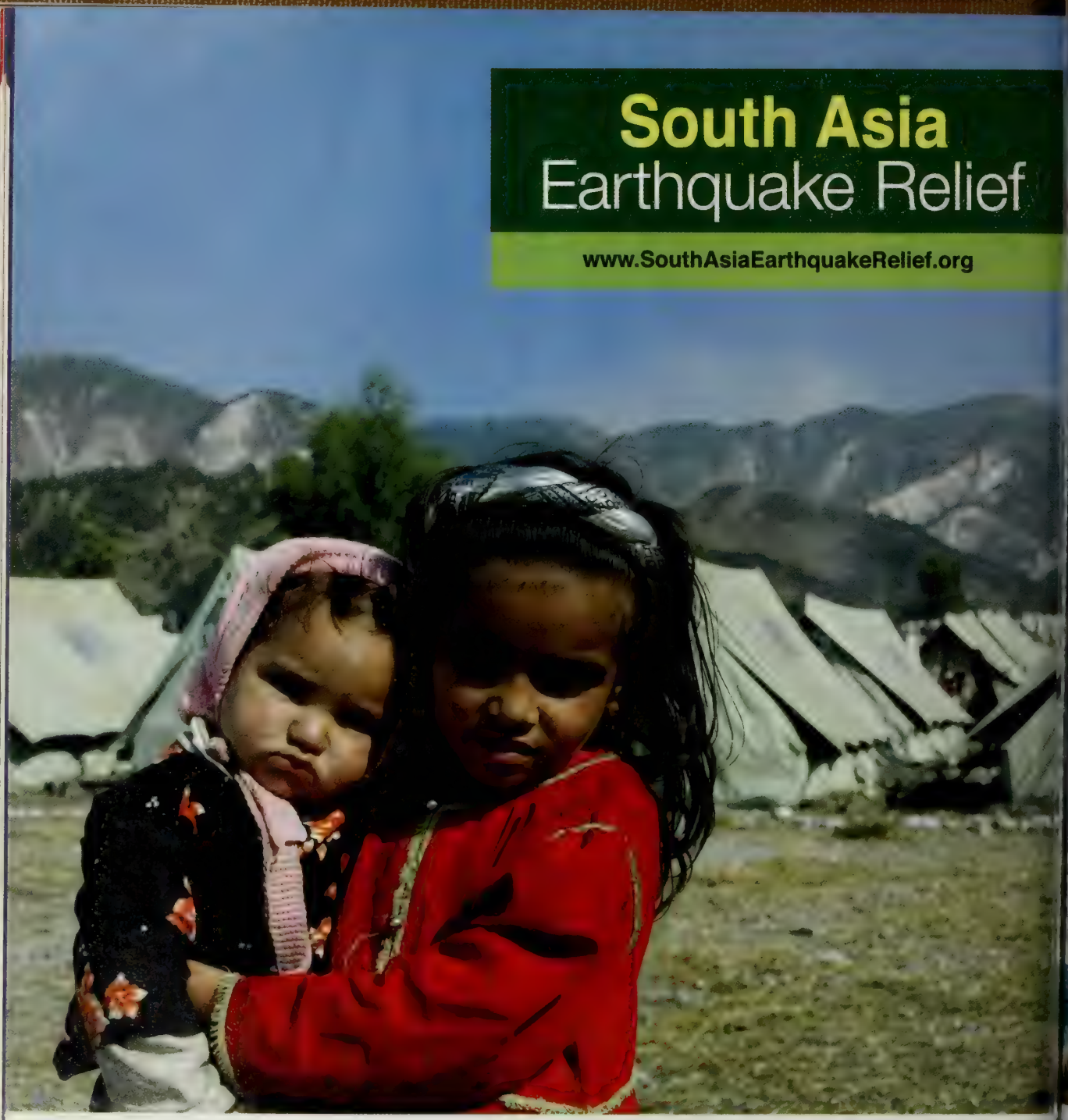

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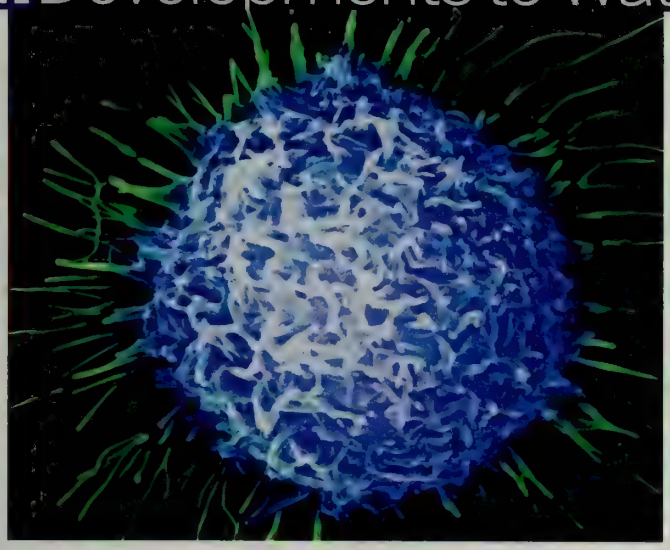
Before nations can luce noise pollution that y trouble marine mmals, they need to know at sounds are out there. earchers at the University Vashington's Applied sics Laboratory are taking nventory with devices they igned called Passive atic Listeners (PALs). ored to seabeds in the ific, the South China Sea, Puget Sound, the PALs ntify noises from ships, anoes, storms, waves, and ike, and sort the sound ces by frequency.

Shoppers for athletic s often favor 100% on, but should they? neering students at the ersity of Missouri- mbia built a device to 10 popular brands of s, measuring slippage moisture absorption. The

ct: Mixtures of cotton ylon offer the most able characteristics.

nce the 1950s, scientists known that removing n materials from an ic field lowers the nding temperature. In ar. 2 *Science*, researchers University of Cambridge, nd, say that thin films of skite PZT can produce cant cooling effects activated by an electric his could lead to novel g components for ter chips.



DIAGNOSTICS

A CLOSER READING OF A PROSTATE THREAT

MIDDLE-AGED MEN are advised to have their blood screened for prostate-specific antigen (PSA), which tends to rise in men with prostate cancer. But doctors complain the test generates too many false positives and can't differentiate between aggressive tumors (above) and slower-growing ones.

A more accurate test may be on the horizon. Working with Dr. William J. Catalona, a prostate cancer surgeon at Northwestern Memorial Hospital who first developed the PSA test, diagnostics maker Beckman Coulter has developed a desk-size machine that can detect two distinct forms of the antigen. One indicates that the tumor is unlikely to prove fatal; the other calls for immediate treatment.

This spring, doctors at Northwestern University and Baylor College plan to begin testing the device's accuracy by training it on stored blood samples from patients whose outcome is already known, says Charles Weinzierl, manager of market development at Beckman Coulter's facility in Chaska, Minn. *–Michael Arndt*

CYBER SECURITY

THE DECOY IS IN THE DATA

PHYSICS LABS around the world are racing to perfect quantum cryptography, hoping to encrypt data with particles of light, or photons. Physics professor Hoi-Kwong Lo and his colleagues at the University of Toronto say they have taken an important step. They created keys that are used to encrypt messages—composed of pulses of photons—then intermingled them with "decoy" photons and transmitted them over 10 miles of fiber-optic cable. A separate transmission told the receiving computer how to sort the meaningful photons from the decoys, so that the original messages could be reassembled. Such transmissions aren't exactly tamper-proof. But under the laws of physics, any attempt by hackers or others to inspect the decoy photons also alters them, alerting the researchers that their transmission has been hacked. The work appears in the Feb. 24 *Physical Review Letters*.

–Brian Grow

MEDICINE

HOW PRECIOUS METALS WORK THEIR MAGIC

GOLD AND PLATINUM have been used to treat autoimmune diseases such as lupus and rheumatoid arthritis since the 1930s, but how the metals work their magic has never been clear. While looking for new drugs to treat these debilitating diseases, researchers at Harvard Medical School may have stumbled on the answer.

Minute quantities of the precious metals appear to neutralize a type of protein called MHC class II, which the body employs to rev up the immune system when viruses or bacteria cause an infection. These MHC proteins typically hold up bits of pathogens, like red flags, to summon the help of white blood cells. But in the case of autoimmune disease, the proteins wave around fragments of body tissue, which causes white blood cells to attack the healthy tissue. That leads to inflammation and other autoimmune responses. Platinum and some forms of gold seem to pry the fragments loose.

Scientists hope the discovery of how gold halts the autoimmune response will lead to metal-based medicines that work faster than existing gold and platinum drugs and don't cause side effects.

–William C. Symonds

Yahoo's Boulevard Of Broken Dreams

Its effort to redefine online entertainment has been a surprising struggle

BY BEN ELGIN

A YEAR AGO, YAHOO!'S ambitions in the media industry were nothing short of audacious. Yahoo! Inc. execs spoke of creating smash-hit, medium-defining programming for the interactive world, a sort of *I Love Lucy* for the Internet. With former movie mogul Terry S. Semel as its CEO and former ABC television Chairman Lloyd Braun running the media outfit, Yahoo looked capable of achieving its aspirations. The company furiously set to work on a number of high-profile content ideas, from adapting the abandoned reality-TV show *The Runner* into a multimillion-dollar Internet program to developing a home-electronics reality contest, dubbed *Wow House*.

Today, after a turbulent year in the media business, Yahoo is singing a much more modest tune. Large projects such as *The Runner* are in a holding pattern as Yahoo susses out the potential business opportunities. *Wow House* has been sent back to the drawing board. And headline-grabbing content partnerships, which Yahoo once pursued with zeal, are increasingly ending up at competitors such as America Online, Google, and Microsoft's MSN. A company that a year ago moved its media biz to Southern California and hired up a stream of Tinseltown execs is suddenly scaling back its Hollywood rhetoric. "It's fair to say we've had a shift in thinking over the past 15 months," says Daniel L. Rosensweig, Yahoo's chief operating officer.

It's the media education of Yahoo Inc. While rivals America Online Inc. and Google Inc. came on strong last year, Yahoo struggled to find its footing. Yahoo's original content endeavors, from celebrity

BRAUN The tech neophyte is finding it tough to transfer his TV success to the Net

blogs to the online reality shows, have
en flat or been stuck in development. W
traffic numbers have stalled on a coup
its media sites. And Yahoo's media gr
only hit internal financial targets last
after revising them downward, accor
to two sources familiar with the m
group. "Things at Yahoo just get stuc
Never Never Land," says an executiv
one of Yahoo's content partners.

Yahoo says its media group
formed well and met expectation
2005. It points out traffic to news, m
and games sites lead their catego
while movies ranked No. 2. "They
what we asked them to do and
some," says Rosensweig.

Making matters more difficult, H
wood began wresting back control
online fate last year. The studios st
putting TV shows, sports clips, and
mated spots on their Web sites rather
just turning them over to the Int
companies they increasingly see as
petitors. When media companies are
ing to share
content with
players, the
ten want h
and higher
For comp
such as Yahoo, whose investors
grown accustomed to fat margins, th
creasing cost of content is a prob
"I don't want to create a n
where we have to spen
enormous amount of m
but we haven't move
needle on a long-term
at Yahoo," says Braun
Instead, Yahoo's
ambitions will focus
on its technology
While Yahoo's c
crew struggled, its t
made big strides d
the past year in ha
ing the do-it-yo
media revolutio
ing place onlin
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its myriad

erties, from news to es to music.

ne example of the new di- on was Yahoo's recent o feed of Howard Stern's ratory last day on FM ra- Not only did 4 million le watch the video ms, they also used other o offerings, including p discussions and music ing. Sirius Satellite Radio the new home to Stern's , purchased Yahoo ads.

is strategic retreat opens ield to competitors. NBC bruary, for instance, part- l with ESPN.com and le to showcase video of the Olympics. One h earlier, Google partnered with CBS lude some shows, including *Survivor*, new video store. AOL, meanwhile, fol- l its exclusive online coverage of the 3 musical event in July with a deal to op an online reality program, dubbed *Rush*, with longtime Yahoo partner Burnett Productions Inc.

move by Yahoo last year helped ce- Google as a contender in online con- When CBS in September sought a er to distribute the premiere of *body Hates Chris*, it first reached out oo, asking only for a link back to its compensation. When Yahoo balked, ook the deal to Google, giving the leader its first significant content nd driving millions of users to its nce then, Google and CBS have part- on Google's video store as well.

oo execs insist the deal didn't make for them. Although it will continue pete for large content deals, Yahoo will only do so if it can add value. ot just about bringing people to the s about keeping them engaged, en- them to share and create their own t, and making sure they come says Braun.

ainly, Yahoo has plenty going for it. mpany boasts over 400 million vis- nd a media division that streams usic videos than anyone else each . But its reluctance to aggressively outside content unless it can add twist could hurt its efforts to pull rtisers. As brand-name advertisers shift more of their spending from on to the Internet, they're most en- video content with broad appeal. s considered the safe bet for video ht now," says Matt Wasserlauf, ad seller Broadband Enterprises. nan charged with striking this del-

HOT ZONES Yahoo's war correspondent Kevin Sites reports from trouble spots

icate balance for Yahoo's media offerings is 47-year-old Braun. In many ways, it's an odd role for the former ABC executive who made a name for himself developing megahits such as *Lost* and *Desperate Housewives*. Braun, a self-proclaimed tech neophyte, knew little about the Internet before joining Yahoo in November, 2004.

Despite a steep learning curve, Yahoo's brass say Braun is turning their vision into reality. They point to Yahoo's handling of the Olympics as a prime example. ESPN and Google grabbed headlines by partnering with NBC. Yahoo, by contrast, set up its own Olympics site and packed it with headlines, exclusive columnists, and community-generated content, such as photos taken by spectators and posted on Flickr, Yahoo's photo-sharing service.

There could be costly casualties as Yahoo gets its arms around this evolving strategy. One of Braun's earliest pet projects was resuscitating *The Runner*, which features a stealth operative traversing the country with hidden video cameras. Online viewers watch the programs, search online for clues, and attempt to capture the runner to win a prize. But uncertainty about how to recoup the hefty filming costs, estimated at between $5 million and $10 million, put the show in limbo.

Then, in January, AOL began holding quiet conversations with Burnett & Co. about a different reality concept. Within 10 days, the two sides had hammered out details for *Gold Rush*, an online treasure hunt of sorts. Now execs from Burnett and AOL are teaming up to market the program to potential advertisers. A Hollywood partner who had been in lockstep with Yahoo since 2004 is now rolling the dice with one of Yahoo's biggest rivals.

Braun and Yahoo's other execs argue that they're right to take their time in evaluating the reality concepts. Once they're sure the model is right, they'll forge ahead. It's a stark change for Yahoo's media division. Cockiness has been replaced with caution.

Anatomy of a Cold Streak

Yahoo! hired former ABC Chairman Lloyd Braun in 2004 to help develop and package blockbuster online content. But he has struggled to come up with hits. A few of the key projects he has pursued:

THE RUNNER Yahoo has been trying to resuscitate this abandoned reality-TV idea for the better part of a year, with little to show for it. The show's developers, Mark Burnett Productions, may be tired of waiting: It inked a deal with America Online in January to develop a similar concept.

TREASURE HUNT Yahoo's brass has been working quietly with Steven Spielberg to develop an online scavenger hunt of sorts, with clues buried on far reaches of the Internet. AOL's project with Mark Burnett, dubbed *Gold Rush*, may have also scooped this Yahoo effort.

PUPPET NEWS Borrowing an idea from television history (think Howdy Doody), Braun proposed an online newscast delivered by puppets. The idea gained little traction inside Yahoo and appears to have been squelched.

FAILED PILOTS Braun proposed working with NBC to develop an online catalog of ill-fated television pilot episodes. Trouble is, the networks don't own the rights to these failed pilots. The idea quickly fizzled.

ONLINE JOURNALISM Yahoo has launched a dedicated Web site for war correspondent Kevin Sites, who writes and blogs from war zones across the globe. It has won critical acclaim but little advertiser support.

Open Season On Open Source?

Aggressive acquisitions by Oracle and others could co-opt the movement

BY SARAH LACY

IN 1999, ETHAN GALSTAD WAS thinking about starting a business with a friend. Among other things on their to-do list was digging up software to monitor their network and flag any problems. They couldn't afford any of the programs on the market, however, so Galstad wrote his own. Almost on a whim, he posted it on an open-source Web site where geeks around the world browse code and download programs for free.

Galstad's original business idea never took off. But his software quickly became a hit. Some 50,000 companies downloaded the open-source project, called Nagios, and rely on it to monitor their networks. Galstad, now 31, works with other coders around the world to keep the software up to date and earns money by consulting. "It has really grown on its own, beyond anything I could have imagined," he says.

Galstad is one of the many true believers who have helped turn open-source software into a booming field. The highest-profile, open-source project is the free operating system Linux. Yet there are dozens of other projects to develop open-source versions of almost any software companies pay money for. The projects, whether organized by a company or by a nonprofit, are typically supported by an army of volunteers. Altogether, tens of thousands of programmers work together on open-source software, typically sharing their code with one another over the Net.

Their success has had a far-reaching impact on the tech industry. Linux has spread to more than 25% of the world's servers and has become a legitimate rival to Microsoft Corp.'s Windows. The open-source approach is compelling enough that IBM and Sun Microsystems Inc. have become major supporters, utterly changing how they market software. There's even talk of taking the open-source method into semiconductors and tech hardware.

Yet in recent weeks the open-source community has been thrown into tumult. Software giant Oracle Corp. has acquired two small open-source companies and is in negotiations to buy at least one more. Many experts believe this is the beginning of a broader trend in which established tech companies scoop up promising open-source startups. While the validation is thrilling for Galstad and others in the community, it's also unsettling. Many young idealists who set out to create an alternative to the tech Establishment now find themselves becoming part of it. "When your main goal is to turn a profit, you start to lose some of the things that made open-source projects thrive," Galstad says.

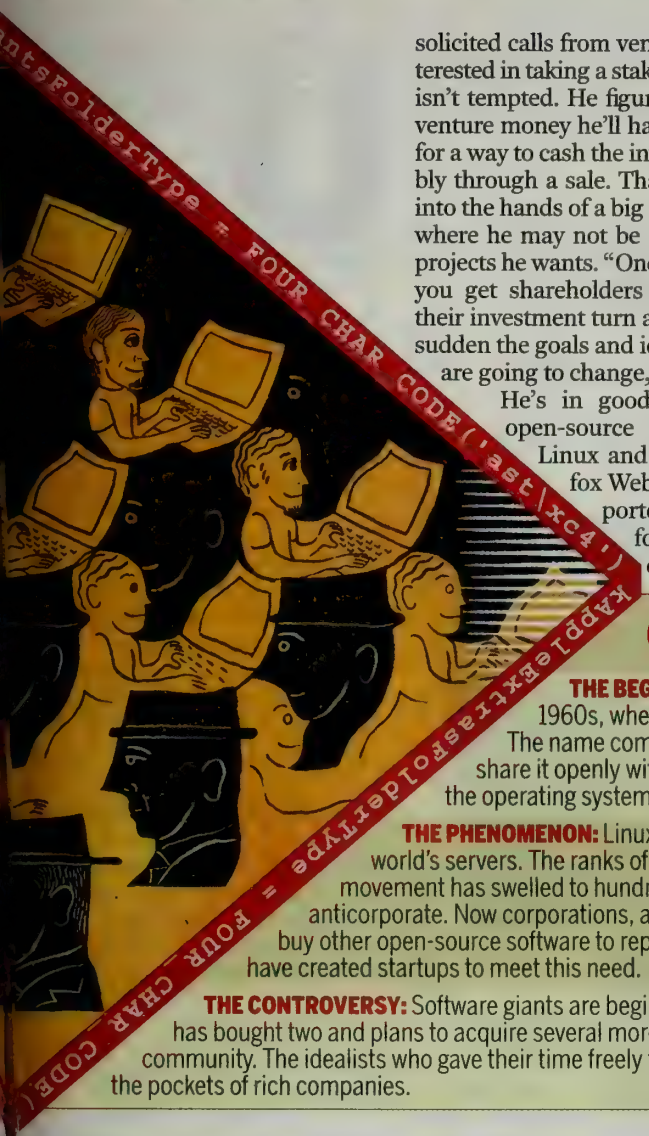
> The trend could hurt the open-source ethos

The fear is that a round of buyouts could undermine the ethos of open source. Many coders volunteer their time, spending nights and weekends testing bugs and writing patches because they see themselves as part of an important, grassroots movement. Will that motivation remain if they're just helping to fill the coffers of Oracle or other tech giants?

Oracle, which has quickly become the most aggressive acquirer in the field, is undeterred. After striking deals for database companies Innobase Oy and Sleepycat Software, it's in talks to purchase JBoss, an open-sour company that makes so-called mi ware, for as much as $500 r Sources close to Oracle say this is o beginning of an open-source sh spree. These companies, thoug typically charge little or nothing u for their software, bring in prec and profitable subscription fees. " moving aggressively into open s said Chief Executive Lawrence J. at a Feb. 8 investor conference. " not going to fight this trend."

FEELING THE TUG

FOR DECADES, THE ONLY peop cared about open source were th who stayed up for all hours swill Cola and writing code. But the mo has gone mainstream in recent IBM has been one of its biggest c ons, pushing Linux and hiring sor



solicited calls from venture capitalists interested in taking a stake in Nagios. But he isn't tempted. He figures that if he takes venture money he'll have to start looking for a way to cash the investors out, probably through a sale. That could drive him into the hands of a big software company, where he may not be able to pursue the projects he wants. "Once you incorporate, you get shareholders who want to see their investment turn a profit, and all of a sudden the goals and ideals of the project are going to change," he says.

He's in good company. Many open-source projects, such as Linux and the popular Firefox Web browser, are supported by nonprofit foundations that can't be sold. In addition, some of the most successful open-source companies are resisting outside capital, including Digium Inc., which makes low-cost telephone systems for small companies. Mark Spencer, Digium's 28-year-old CEO, has warned several peers about cashing out. "If you give up control of the company, either through percentage ownership or by giving up control on the board, you are effectively selling your company, not taking an investment," he says.

But others see outside cash as a huge help in getting their software into the hands of people who want to use it. Consider Teodor Danciu. Three years ago the Romanian coder wrote JasperReports, a business analytics program that several hundred thousand companies have downloaded. He was updating it on nights and weekends when its popularity became too much for him to handle. So he sold to a Silicon Valley startup, which renamed itself JasperSoft Corp. and hired him as part of the deal. He says it was the perfect opportunity for him to do what he loves: working on the code full-time while making money. Meanwhile, the business arm can invest more resources in support and training than he could on his own.

DAY JOBS

CODERS SUCH AS Danciu have a powerful role model in Linus Torvalds, the Finnish programmer who wrote Linux in 1991. Torvalds strikes a balance between community and cash. He focuses on managing the Linux code while leaving the business aspects to companies such as Red Hat and Novell and the nonprofit Open Source Development Labs (OSDL), which organizes advocacy groups around the operating system. He and his followers haven't resisted commercialization. Torvalds draws a salary from OSDL, and many of his Linux contributors have day jobs at companies such as IBM and Oracle. Andrew Morton, Torvalds' top lieutenant, says such efforts have helped make the code stronger.

A big reason people such as Morton and Torvalds are sanguine is their belief that while open-source companies may be for sale, open-source communities aren't. If contributors feel that Ellison & Co. are taking the software in the wrong direction, they can balk and start up a new project, taking along any of the open code they want. That would hurt Oracle's open-source credibility and leave it with little to show for the millions it has spent. "If Larry thinks he can have his way in the open-source community, he's going to find he can't get any developers to work [with him]," says Bruce Perens, a key figure in the open-source movement. ■

Community in Tumult

THE BEGINNING: The open-source software movement dates back to the 1960s, when programmers began to swap software code with each other. The name comes from the idea that any participant who writes code should share it openly with everyone else. The best-known open-source project is Linux, the operating system started by Finnish programmer Linus Torvalds.

THE PHENOMENON: Linux has become a booming success, now used to run 25% of the world's servers. The ranks of programmers who contribute their time to the open-source movement has swelled to hundreds of thousands, many of them young, idealistic, and anticorporate. Now corporations, attracted by the low costs and flexibility of Linux, are beginning to buy other open-source software to replace their existing databases and middleware. Entrepreneurs have created startups to meet this need.

THE CONTROVERSY: Software giants are beginning to scoop up the open-source startups. Oracle, for example, has bought two and plans to acquire several more. This has set off tremendous controversy in the open-source community. The idealists who gave their time freely to help create great software now fear they're simply helping line the pockets of rich companies.

best engineers. The company has re than 900 software engineers ng on open-source projects. Venture lists have rushed into the field, too, g millions into scores of startups. outside money has led to the cre- of two parallel open-source worlds. e side are the traditionalists who een around longer and typically have outside investors. They tap e worldwide community of coders sh their software. Then there are wcomers who took venture money p shop in the booming field. They ngage much with the network of ource coders, doing most develop- hemselves. For them, open-source about community and more about ing. As traditionalists are offered e money, many are being pulled e second group.

tad is one of the people feeling the says he has received dozens of un-

Laughing Out Loud in Spanish

Warm-and-fuzzy Hispanic TV ads are giving way to the crude and funny

BY DAVID KILEY

Fruit of The Loom
A Mexican, a Puerto Rican, and an Argentine wear the fruit suits

Energizer Battery
This ad plays with stereotypes: A man gets an arm transplant from a Japanese —and can't stop taking pictures

Got Milk?
The "family, love, and milk" campaign was replaced by ads of folks holding on to train straps with their strong teeth

UNTIL RECENTLY evening of adverti on Spanish-langu television was good about as many laugh a trip to the dry clea But as the numbe viewers watching Latino networks Univision tops the likes of CBS s weeks, rates for TV spots are mounti and so is pressure to prevent the kir ad-zapping that bedevils English- guage channels. That's helping to sp creative revolution in Hispanic adve ing as clients take more risks to rea fast-growing market of assimilated sumers with multicultural entertain tastes. More and more, ads marked by stick, frat-house pranks and edgy hum replacing the relentlessly earnest spot have run on Spanish-language TV for than two decades.

Witness the change in ads for most wholesome of products: milk California Milk Processor Board fo past four years has run TV ads feat heartwarming scenes of an exte Latino family, complete with grandm er baking *tres leches* cake. The slogan predictably, "*familia, amor, y leche*" ily, love, and milk). That tack was in contrast with the long-running Milk?" campaign in English-lang media featuring such slapstick scene man in a body and head cast being cookie through the mouth-hole b hospital roommate and then bein alone to grunt for some milk.

The new Spanish-language cam is much closer to the tone of the ori Conceived by Grupo Gallegos, a hot Beach (Calif.) shop, it shows m tableaus of people who have extr narily strong teeth, bones, and hai ad shows commuters holding on to straps with their bare teeth. The sl "*Toma Leche*" (Drink Milk).

It was Grupo Gallegos that sug moving the Hispanic ads closer jokier English-language ones. campaign is ranked as one of th 100 campaigns of all time, but th panic work hasn't been part of tha that makes no sense to me," says a President John Gallegos. It didn much to win over Milk Board Cha Steve James. "We've seen a flat to ing sales line in Hispanic mark some time, and our Spanish ad only speaking to customers we a have," says James, who confesses had deferred to his former agen did not pursue a new strategy in p

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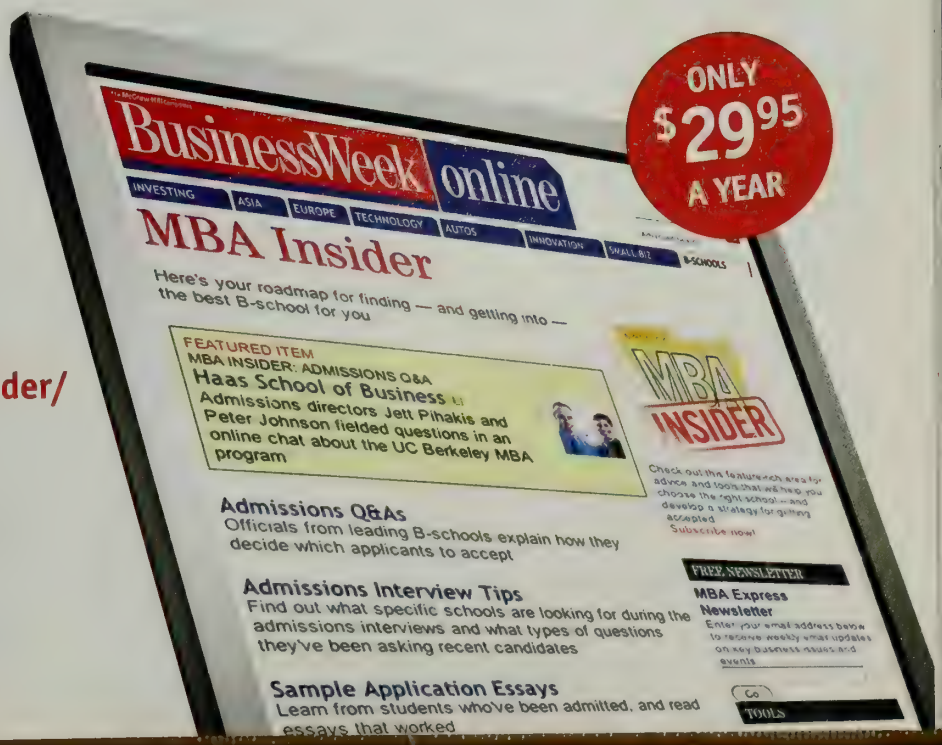

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cause he doesn't speak Spanish.

More dynamic and entertaining fare in Hispanic advertising is a must as that segment's spending power climbs along with education levels. Agencies view today's Latino explosion as similar to the baby boomer phenomenon in the postwar U.S., in which a generation of children who grew up with different mindsets from their more cautious parents became a driving force in a dynamic consumer period. Hispanic buying power is projected to be $926 billion in 2007, up from $580 billion in 2002, according to the Television Bureau of Advertising.

The four-year-old Grupo Gallegos has been a catalyst for advertisers rethinking the conventional Hallmark-card style. Two years ago the agency woke up Hispanic advertising with a TV spot for Fox Sports Net Inc., depicting a Hispanic housewife returning from shopping and detecting a bad smell in her house. Free of dialogue, the camera follows her around the house and finally into her living room, where she finds her husband so glued to a soccer game that he has been watching from the nearby toilet with the door open. "That was a great example of taking a slice of life from a husband and wife, no matter the culture, and pushing the ad into entertainment," says Hispanic marketing consultant Jennifer Woodard, who writes The Latino Marketing Report Web site and blog. Gallegos recalls his excitement when the ad took on much coveted viral status: He received a mass e-mail headlined "Why Women Hate Sports" with a link to the ad. The agency also put Latinos in Fruit of the Loom apple, grape, and banana suits. And last year, Gallegos won awards for an Energizer battery ad showing a Hispanic man, with an arm transplanted from a Japanese man, who couldn't stop taking pictures with his new hand.

Playing with and against stereotypes is at the center of the new genre. It does not come easily, since "not only are Americans comfortable with positive stereotyping as a means to be politically correct, but so are many Hispanics," says consultant Woodard. She points t work of popular comedian G Lopez, known for successfully atta stereotypes of Mexican Amer through humor.

Adios, Grandma

What's driving the move to edgier ads?

- **60%** of Hispanic women now work outside the home, making overly wholesome ad pitches out of date.
- Hispanics are combing the Net for cooler entertainment. Of those online, **41%** visit music sites, vs. **18%** of non-Hispanic Net surfers.
- Spanish network TV ad spending was up **15%** last year, a rate higher than those of both cable TV and the Net.

Data: Nielsen Media Research

LOONY SCENARIOS

A MORE HOSPITABLE climate for taking also doesn't necessarily sin finding the right balance. Virgin M Telecoms Ltd. has gotten looni Spanish than it has in English. Ads th "*No Soy Normal*" not normal) use b scenarios to promo pay-as-you-go plan the Hispanic mark vors. In one TV s man with cocker-s ears flapping in the drives with his girl in a convertible. "W a lot of debate abou far to go but decid important to carry reverence of the brand to all audie says Bob Stohrer, president of bran communications gin Mobile.

Advertisers an creasingly choosi create Hispanic a closely parallel market campaigns than hatch entirel rate strategies fo nos. Southwest A Co.'s general mark for example, depi barrassing social situations for then use the punch line "Want away?" followed by a cheap far Ads by Dallas agency Dieste Ha Partners mirror the general strategy and also push the en making fun of traditional ima Latin masculinity in a way that ficult to sell to clients until rece one ad, a virile young m Rollerblades skates up to a par window to admire his reflectio denly, the tinted window slides and he finds to his uncomfortal prise that two men inside the car miring him right back.

Latinos, says agency CEO Tony want to be entertained and l themselves as much as anyo "And come on," asks Dieste, "ho family dinners and soccer balls look at every night?" ■

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MARLA, BONNIE "We like to say we share a brain," says Marla.

A Sister Act That's Wowing Them

Retailer Claire's Stores is thriving since Marla and Bonnie Schaefer took over

BY DEAN FOUST

WHEN ROWLAND Schaefer, the founder and CEO of Claire's Stores Inc., was felled by a stroke in late 2002, the company was caught unprepared. Even at 86, the iron-willed Schaefer hadn't groomed a successor and had only promoted his two daughters, Bonnie and Marla, to vice-chair positions to appease the board. Left with few choices, the board tapped the two sisters as "acting co-CEOs"—but gave them orders to begin searching for a seasoned executive who could step in if their father wasn't able to return. "They had Claire's in their blood, but they were not proven quantities," says director Bruce G. Miller, a managing director at Ryan Beck & Co.

HOT GROWTH COMPANIES

Privately, though, Bonnie and Marla chafed at the idea of bringing in an outsider to run the $1.3 billion retailer, which sells inexpensive baubles, bangles, and bows for teens and tweens. The pair had worked most of their adult lives at Claire's and figured any outsider would need at least a year to learn the business. "We said, 'We know all this stuff, let's just go do it,'" recalls Bonnie, 52, who handles real estate and store operations from the company's headquarters in Pembroke Pines, Fla. Marla, who is four years older and the more extroverted of the two, oversees merchandising and investor relations from New York. Together they form a unique executive partnership—a long-distance sister act on their complemen strengths. "We lik say we share a br says Marla.

Back in 2002 the ters simply ignored directors' orders threw themselves the job. They did so that after a year board dropped the ing" from their Smart move, becau the first two yea their tenure, p nearly doubled, to million, on a 28% r revenues—a perf ance that earned th No. 56 ranking on *nessWeek*'s 2005 Hot Growth comp For the fiscal year Jan. 31, analysts Claire's to record a ditional 19% increase in profits vestors clearly have bought in: Sha Claire's have soared 157% since B and Marla took charge in Nove 2002. "Wall Street was highly ske at first, but they've done a great says Eric Beder, analyst at Brean M Carret & Co., a New York securitie

The Schaefer sisters admit they b ed from shifting fashions. G was dead, and teen girls were into accessories again. But analysts credit them with revitalizing a company that had been slowed by two troublesome acquisitions—a boys' apparel division called Mr. Rags (which was sold in May, 2002) and a second accessories chain called Afterthoughts.

More celebri licensi more high-margi jewelr

GIRL MAGNETS

BONNIE AND MARLA quickly reshaped the Afterthoughts unit, which had been renamed Icings, to appeal to the 17-to-27 crowd. Buying became more scientific: Instead of relying on the personal whims of the

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MALL'S WELL More market research helped revitalize Claire's

buyers, as their father had, they began using more market research to ensure they were on the cutting edge of teen trends. The sisters pushed more jewelry, which carries high margins. They also became more aggressive about licensing celebrity names they hope appeal to young teens: The company in February launched an exclusive line of Mary-KateandAshley cosmetics, and later this spring it will unveil a line of costume jewelry hand-picked by pop singer Mariah Carey. "The stores have become a hangout for teen girls," says Eugene Fram, professor of marketing at the Rochester Institute of Technology.

Meanwhile, Bonnie and Marla reorganized the management structure to break down fiefdoms "and make sure everyone was rowing in the same direction," says Bonnie. To help them drill deeper into store data and, they hope, spot sales trends earlier, the two recently hired the company's first-ever chief information officer. And while it was Rowland Schaefer who pushed the company into Europe and Japan in the 1990s, his daughters are taking the international expansion to the next level. To get a toehold in markets they don't know well, Bonnie and Marla have begun franchising the Claire's name to retailers in countries such as South Africa, Kuwait, and the United Arab Emirates.

That the sisters adapted to their new roles so well shouldn't be surprising, since they grew up in the business. Marla was a teenager when she took her first business trip to Europe with her father. She later gravitated toward merchandising, which required frequent travel to Asia to find suppliers to produce the 11,500 or so items that Claire's stocks. Bonnie, who says her father fired her from her first job as an assistant store manager because she "didn't have the right work ethic," returned a year later and found her niche on the real estate team, which contracts for space with mall landlords. Neither bothered w business school; their training was the job.

CLOSE AS...SISTERS

BUT IT WASN'T easy for them to be tak seriously as they came up the ranks; t Schaefer family (their father is still ali controls roughly one-third of the o standing shares of the company. "No c believes you're there for any reason otl than that you're a member of the famil says Marla. And the two say it was di cult to get their father, even when he v in his 80s, to cede any power. "We wo pry his fingers off and say, 'Let us do it, us do it, Dad, we're adults now,'" rec Bonnie. "It's not that he was giving o daily control. We were taking it."

As co-CEOs, they've found a way make what could be an uncomforta arrangement work. They talk on phone several times a day, and w they're together they often finish each er's sentences. Even as Bonnie compla that Marla keeps interrupting her, twice reaches over to pick lint from her ter's sweater. "Never in my wildest dre did I think I'd be working things out my sister," Bonnie jokes. Indeed, t vowed from the outset to smooth over problems privately so that emplo would never see a schism between th "We have our differences of opinion," mits Marla. "But we also know tha we're not together on something, no or the company is going to buy into it."

When it comes to thinking about t own successor(s), Bonnie and M aren't necessarily counting on the generation of Schaefers. Bonnie do have children, and Marla's daughters just 15 and 13. If they ever show inte in Claire's, she says, she'll insist they take a job elsewhere "to have an app ation of working in a family business

BIOS

Bonnie Schaefer

TITLE Co-CEO, Claire's Stores since November, 2002.

BORN Mar. 16, 1953, in Chicago.

EDUCATION Studied nursing at Skidmore College in early 1980s but didn't graduate.

FIRST JOB Assistant store manager for Claire's; fired when father concluded "I didn't have the right work ethic."

ON SHARING POWER "If you asked Marla if she'd rather be CEO alone or with her sister, she'd say alone."

FAMILY Divorced.

CEOs-TO-BE Dad, Bonnie, Marla, 1950s

Marla Schaefer

TITLE Co-CEO, Claire's Stores since November, 2002.

BORN May 16, 1949, in Chicago.

EDUCATION BA, liberal arts, Florida International University, 1973; Masters in organizational psychology, Columbia University, 2003.

FIRST JOB Working in father's wig business.

ON SHARING POWER "Bonnie would say alone, too."

FAMILY Married with two teenage daughters.

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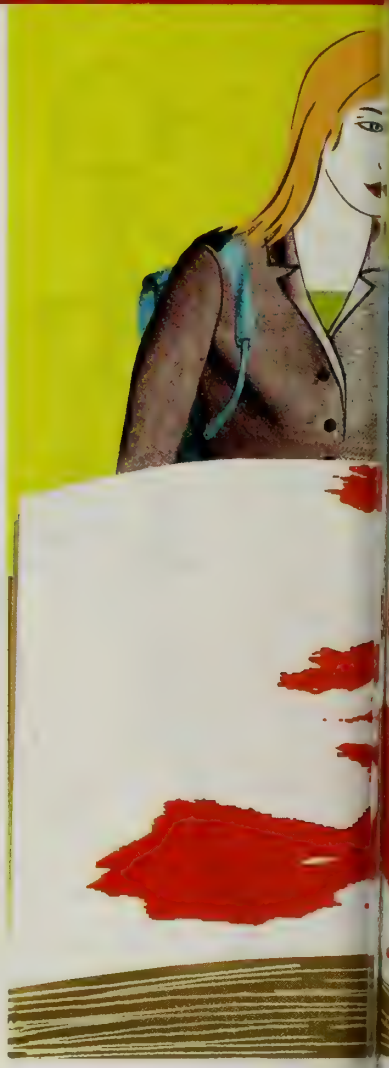
More B-school students are studying abroad, creating an international class of grads. **BY JACK EWING**



SOON THE NEW MBA STUDENTS at RSM Erasmus University in Rotterdam would be hunched over textbooks for their finance and marketing courses, but first it was time to pound on a goatskin stretched across a hollow piece of wood. That's part of the orientation for RSM's 96 incoming international MBA students, most from outside the Netherlands, to help them get used to crossing cultural barriers and working together as teams. Their goal: learn the art of Sewa-style African drumming—in a day. Under the tutelage of instructors from Sewa Beats, a Swiss company that specializes in corporate drumming sessions, the students became passable tribal drummers by nightfall, performing complicated Mandinka rhythms in groups and, in the judgment of one observer, rocking the house.

Across Europe these days, B-schools are using team-building exercises like this to deal with student bodies that have undergone radical changes. Once populated almost entirely by locals, many B-schools now draw from dozens of countries, and no one nationality dominates. Properly mastered, this diversity gives students an edge in the job market, especially with multinational companies that prize students able to operate comfortably in unfamiliar cultures. For those contemplating B-school, this means Kellogg, Wharton, and other top U.S. schools aren't the only choice. What's more, they may not be the best choice.

MULTICULTURAL KICK

THAT'S ONE REASON why a small but growing number of North American MBA students are choosing European schools—to give their résumés that multicultural kick. "It gives you an opportunity to experience a diverse student [illegible] you can't find at U.S. business sch[illegible] says Marc Comer, a 28-year-old C[illegible]nian studying for his MBA at IMD i[illegible]sanne, Switzerland. Adds Clancy Ch[illegible] 27-year-old New York native in h[illegible] year at London Business School [illegible] "This is especially important as bu[illegible] becomes more global. [It's] a dry r[illegible] being relocated to another country."

U.S. students are also flocking [illegible] Continent because the programs [illegible] bargain. A typical one-year Eu[illegible] course of study—including tuition, [illegible] expenses, and lost wages—costs r[illegible] half what a two-year U.S. program [illegible] But as with all bargains, this one co[illegible] a cost. Owing to job market differ[illegible] graduates of top European progra[illegible] erage $103,000 at graduation, [illegible] $135,000 for U.S. grads.

So far, the number of U.S. stude[illegible] plying to MBA programs abroad is s[illegible] less than 2% of the total U.S. ap[illegible] pool. But since 2000 the number ap[illegible]

opean schools has soared, as they heir reputations and word gets out e top programs are conducted in h. In 2005, some 1,578 potential stu- rom the U.S. had their test scores British business schools, almost the 883 who did so in 2000, ac- g to the Graduate Management Ad- Council, which administers the the most widely used MBA admis- st. In France the number of U.S. ap- s rose from 582 to 844. Spain, with English-language programs, in- the ESADE and IESE business in Barcelona, saw an increase from 000 to 442 last year.

can these students expect if they Most schools offer a wide variety of designed to make students feel at their new surroundings—from cs, such as assistance obtaining the oddly personal. When Brenna a 20-year-old undergraduate student at the University of Ot- rived in Germany in January for a semester at the European Business School in the Rhine River burg of Oestrich-Winkel, a staff member picked her up at the Frankfurt airport at 7 a.m. on a Saturday. The EBS person then took Jansen grocery shopping before dropping her at a furnished apartment that the school had helped her find. "They were so helpful," says Jansen, who spoke only rudimentary German. "I would have been lost." IMD and ESADE, among others, hire outside agencies to help students find apartments and deal with lease formalities. "You have to do a lot of legwork, and students don't have time," says Betsey Tufano, associate director of admissions at ESADE.

By studying in Europe, American students fortify their résumés

Helping students' families adjust may be just as important, since stress in a relationship can seriously hurt a student's academic performance. IMD offers a kindergarten for students' children, while ESADE lets partners take part in a two-week intensive Spanish program that precedes the beginning of regular study.

For students seeking a true international experience, bonding with classmates outside their national cliques is all-important. To facilitate this, the savviest schools are getting scientific about integrating student diversity into the curriculum. IMD and France's INSEAD use special software to assign students to study groups. The aim is to create teams not only from diverse nations but also from diverse work backgrounds. At IMD, where study groups also engage in outdoor training, students are pushed to analyze team dynamics to learn leadership. They also are urged to look closely at themselves, even to undergo psychotherapy if they choose. It's included in tuition.

Ultimately, much of the burden of breaking down boundaries falls on the students themselves. LBS has dozens of clubs, organized along national lines and according to interests such as marketing or consulting. Nikhil Kejriwal, a 26-year-old from Calcutta majoring in finance and marketing, fondly recalls eating turkey and playing board games at a Thanksgiving Day event sponsored by the American Club. Stephanie DiChiara, a 30-year-old New Jersey native who is studying entrepreneurship at LBS, enjoyed an orientation week game in which students used skits to poke fun at their own national stereotypes. DiChiara, who lived for a decade in California, took part in a Valley Girl skit. "It is a little daunting when you first come over and don't know anyone or the city, but the school does connect you with people," she says.

Because so much depends on the students themselves, the best candidates for international MBA programs tend to be well traveled already. Nat Chaturaphat is

from Thailand but attended boarding school in Britain and got her undergraduate degree from the University of Oregon before enrolling at RSM. "I didn't have culture shock," she says. INSEAD accepts only students who speak one language fluently in addition to English and requires them to learn a third language before they graduate. That tends to weed out the provincials. INSEAD is one of several schools that operate on the philosophy that too much student handholding can be a bad thing. After all, as globe-trotting executives the students will have to fend for themselves. "We try to help. But we believe this is part of your training," says INSEAD D Gabriel Hawawini.

If all goes well, an interesting th happens to international MBA stude They drift from their national cliq "Once they start working in groups, t natural affiliations are with people have the same world outlook," says Denfeld Wood, a former U.S. Air F pilot in charge of IMD's leadership gram. With business ever more glo mastering the art of cross-cultural n agement may be worth the price o ition alone. ■

–With Kerry Capell in London Andrea Zammert in Fran

Visa Students Welcome

For more information, visit these schools' Web sites or view profiles at businessweek.com/bschools:

ESADE	www.esade.es
Cambridge	thecambridgemba.com
HEC	www.hec.edu
IMD	imd.ch
INSEAD	www.insead.edu
IESE	iese.edu
London Business School	www.london.edu
RSM Erasmus	www.rsm.nl

Vive les Différences

On a French hilltop, multilingual business students from all over get a taste of teamwork. BY CAROL MATLACK

GLASS WORK Tasting African wines at HEC

JENNIFER MILLER WAS SURprised when a fellow MBA student asked her to put on a yoga demonstration during an "India Week" cultural celebration last fall at the French business school, HEC. "I said, 'What, don't any of the Indian students do yoga?'" recalls the U.S.-born Miller. "But none of them did."

Cultural stereotypes don't last long at HEC, which draws students from 55 countries to a hilltop campus in the Paris suburb of Jouy-en-Josas. The MBA program, established in 1969 at France's elite Ecole des Hautes Etudes Commerciales, has undergone a striking transformation. As recently as 1997, the majority of its students were French and the program was little known overseas. Today, thanks to aggressive international recruiting, only about 15% of students are French, while roughly one-third each are from Asia and the Americas. All core courses are taught in English, although about a quarter of the students opt for additional business courses in French.

INTERPERSONAL EMPHASIS

ALONG WITH GREATER diversity has come global recognition. "We are a symbol of France's openness to the world," says Associate Dean Valérie Gauthier, who oversees the MBA program. HEC offered a dual-degree program with York University's Stern School of I ness since 2004, and with Tsinghua versity's School of Economics & Man ment in Beijing since last year.

HEC isn't the only European B-sc with a strong international flavor. B small size—just 200 students—and tively long 16-month program (comp with only 10 months at France's INS and Switzerland's IMD) allow studen forge close relationships with others different backgrounds. Indeed, an phasis on interpersonal skills is on HEC's selling points. During the eight months, each student is assign a group of five or six students who intensively together on projects. agreements arise more often from d ences in professional training—engi vs. financial types, for example— from culture clashes, says Ni Hobeilah, a student from Syria. "If y here to adapt and open your eyes, great place to be," he says.

For most students, HEC is mere latest stop in an impressive global i ary. Hobeilah graduated from the A can University of Beirut and worke French company in Dubai, and spent six years on development pr in Africa. Students are required to one foreign language besides En and 80% speak at least three langu

An India Week celebration seems necessary for such a cosmop crowd. But participants say that suc dent-organized activities reinforce t prit de corps. Every spring, HEC h sports tournament for students fr European MBA programs who co in events ranging from basketb mountain biking. With that kind o petitive spirit, maintaining its place MBA big leagues should be easy. ■

Making Those Connections Work

w a Dutch B-school is helping its diverse student dy develop lasting networks. BY JACK EWING

BORN IN VIETNAM, RAISED in Washington, D.C., and frequently on official business in the Middle East, Geneva Pham was hardly a stranger to the world when she enrolled at RSM us University's international MBA am in Rotterdam. "It's not like it's irst time I met someone from nd or Germany or Africa," says , 35, who previously was an inter- al program specialist for the U.S. erce Dept.

be-trotters like Pham are the rule g students who choose one of the h-language MBA programs that are rating in Europe. "The program is able United Nations of students," like Page, a South African who is f RSM's international MBA and ex- MBA programs. Still, the schools ing to offer more than a shallow, od experience. Asks Page: "How get them to bring diversity into the om, to engage with it, grapple with then take it out?"

answer, at least at RSM, is tech- Dianne Bevelander, executive di- f RSM programs, is using software the networks that students form themselves and track the student tions over time. School adminis- hope to use the lessons learned to tudents how to more effectively he networks they'll need to suc- a global business environment.

weeks after students arrived in , Bevelander asked them to iden- r personal networks. A question-

A U.N. OF STUDENTS Pham (center) with her RSM peers

naire asked them to name students with whom they work, those from whom they seek ideas, and those with whom they socialize. Then Bevelander color-coded the three types of connections to produce an image of the current class that, on a PC screen, looks like a lacework project gone haywire.

But patterns emerge. "This group works well together as a team," says Bevelander, pointing at an octagon representing one student work group. "But if you look at the social network, they don't talk to each other at all." Indeed, the lines representing social connections all lead to other groups. The lesson: Teams can get the job done even if the members don't like each other that much.

GRAB THE SPOTLIGHT

NOT SURPRISINGLY, early in the program students tend to cluster according to native language. Bevelander expects that to change as the 15-month program progresses and students create new alliances founded on interests and temperament. As a rule, Bevelander found, women appear to be better at networking than men.

Bevelander plans to repeat the survey twice more before the class graduates. Results of the study are kept confidential, but students get to see who, among the people they identified as members of their network, reciprocated—their so-called confirmed connections. Then, with the help of Karen Stephenson, a Harvard University anthropologist who studies human networks, students will be encouraged to think about how they can expand and exploit their own connections. Dean Page compares the students to actors on a stage. How can they get beyond being bit players, just trying to get through the program, and learn how to grab the spotlight—a skill they'll need in business? "A lot of it is about understanding yourself," he says.

Bevelander's method is new, so the results aren't conclusive. But students already know that they are learning something valuable. Pham, for example, learned that women from Japan and Taiwan, whom she expected to be shy, could be quite assertive in class. "A lot of stereotypes are breaking down as we move along," says Pham. For students planning a career in global business, that's an important lesson, and one that can't be found in any textbook. ■

A European MBA COSTS ABOUT HALF as much as a U.S. degree, but as with most bargains there's a catch: European B-school grads EARN FAR LESS.

Covering the Mommy Wars

Stay at home with the kids or go back to work? Moms grapple with it in this collection of essays

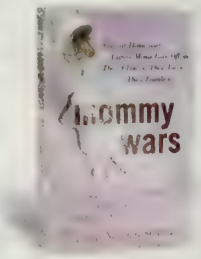
WITH THE ARRIVAL OF THAT FIRST baby comes one of the most difficult and controversial decisions a woman ever makes: Stay at home or go back to work? Leslie Morgan Steiner, an advertising executive at the Washington Post and mother of three, has struggled with the question, too. Her new book, *Mommy Wars: Stay-at-Home and Career-Moms Face Off on Their Choices, Their Lives, Their Families* (Random House), features essays edited by Steiner from 26 women. Personal Business Editor Lauren Young spoke with Steiner, 40, about the clash between the moms.

STEINER No neat categories

Why a book about mommy wars?
Working moms elevate themselves above stay-at-home moms, and stay-at-home moms try to put down working moms. It appears to be a war in which both sides are trying to put the other one down.

You spent three years working on this book. What surprised you the most?
I thought the battle was between stay-at-home and working moms. But women don't fall into these neat categories. Most women see it as a continuum. A mom who left a hard-driving job may be at home now, but she plans on being back at work two years from now.

"Mother Superior," one of the essays by Catherine Clifford, is really interesting. Catherine, who had a high-powered New York-publishing job, fought infertility for 10 years. Then she had three kids quickly between ages 39 and 42, and accidentally became a stay-at-home mom when her child-care situation blew up. Catherine revels in the non-milestone moments: when her daughter puts 23 barrettes in mommy's hair or when her son uses a Tupperware container as a hat.



There were times when I was editing her essay that I thought: "Is she really a superior mother because she is at home?" She argues that there's no one like a mom for taking care of our kids. That is something people want to deny.

And from the pro-work moms?
Leslie Lehr's essay, "I Hate Everybo She gave up a career in film product which is really a mom-unfriendly field cause you have to be able to work aro the clock at a moment's notice. As a sult, she hates her husband, becaus goes to work and doesn't think about ing kids. She also hates stay-at-h moms, and she hates working wo without kids. Something a lot of pe don't want to admit is that there's a l anger involved in motherhood becau the choices you make, or the ones tha made for you.

Have companies gotten better at offering flexibility?
They are more flexible, but the cha are coming much more slowly many women would like. Ther real gray area when you work time. It's hard for companies t hard and fast policies on it. If work a full-time job and are p salary, the truth is that it amounts to 40 hours a week when you start cutting a nebu commitment in half, that's n lous, too. I still work after I leav office at 2:30 p.m. via e-mail or ference calls. It's worth every p I gave up just because I don' guilty about leaving early.

How did business school prepare to be a working mom?
It was no coincidence that I le abusive [first] husband whi Wharton. I was able to leav cause of the support I received my female classmates, surpr because B-school has a reput as a shark tank. Wharton sh me how much better life women when we compete o and fairly.

Do you expect a daddy wars book?
It would be a very short book. Men that introspective. Besides, when come, their lives don't change as When my husband goes on a bu trip, he just packs his suitcase. Whe away, I have to write a three-page for the nanny. I have to find three to pick up my kids from school. I h tell the school to call my husband i of an emergency. And I have to t husband to keep his cell phone on.

BusinessWeek online For an extended version of this Q&A, visit businessweek careers/workparents/blog/

No, Thanks. I'll Take the Stairs

re people are skipping the elevator—and racing their way to the top. **BY BREMEN LEAK**

WHEN A MASSIVE blackout hit New York in 2003, then 35-year-old Jamie Leone had no choice but to take irs to her 28th-floor apartment. ext day, the elevators came life, but Leone opted to keep mbing—and still does, even "my neighbors think I'm she says.

hat climbing is paying off. In the Empire State Building Run-up, an stair-climbing race at the Man- landmark, Leone dashed up 86 1,576 steps) in 20 minutes, 40 sec- about 10 minutes behind the win- t a solid first-time performance. imbing, she says, has taught her reach new heights in other areas ncluding her job at a private-equi- in New York. "It's a physical chal- ou have to learn to focus and push mentally," she says.

day's sedentary cubicle culture, mbing could save you from more t those awkward elevator conver- —it could save your life. The n Council on Exercise recom- 30 to 60 minutes of physical ac- aily. Walking up steps, says alati, ACE research scientist, n as many calories in a 30- period as jogging at a 12- mile pace or cycling at 12 to That translates to 286 calories -lb. climber and 382 for a 200- . Plus, the faster you go, the ories you burn.

urse it's not a holistic exercise so- You should include strength train- flexibility training," Galati says, rt out slow to avoid soreness."

Those with a history of knee problems should consult a doctor first, he adds. Once you're in shape, you'll be ready to race.

The wintry months spanning November to April constitute the stair climbers' racing season. More than 80 major "towerthons" take place around the globe each year, according to the Web site TowerRunning.com. And with new races popping up everywhere from Boston to Taipei, the number of people who bypass the elevator is rapidly taking flight.

SECURITY CONCERNS

JUST ASK Pedro Ribeiro, a Portuguese-born mechanical engineer who lives in Macau, south China, near Hong Kong. Ribeiro, 33, uses his vacation time to compete in stair-climbing races. He recently finished 9th out of about 1,000 at the Taipei 101, a new 91-story race at the world's tallest building in Taipei, Taiwan, and 7th out of 150 elite runners at the Empire State Building. Tower running, he says, gives him more determination in his life, not to mention prize money. He took home $300 from the Taipei 101. The top prize? Nearly $6,000.

Perhaps the greatest challenge for climbers these days is not the steps themselves—but gaining access to them. Heightened security concerns in some high-rises make stairwells off-limits even for people who work or live in these buildings. A week before the Empire State Building event, runner Michael Rosenthal, who works on the 58th floor, was barred from training in the stairwell by building security, citing liability reasons.

Resigned to working out in his 26-story apartment building, the 42-year-old entrepreneur has big plans for the sport. He founded the International Federation of Stair Racers and is launching a Web site, stairracing.com, that he hopes will link the thousands of stair climbers and those who sponsor the races to make buildings more accessible for training and competition. "If my organization could do anything for the sport, it would be to move it out of the category of a novelty," he says. It's a step in the right direction. Only 1,575 more to go. ■

Play by Play in Podcast

FIRST IT WAS BLOGS. NOW PODCAST MANIA is catching on quickly in the sports world. The PGA Tour has a podcast. So does a 13-year-old Boston Red Sox fan with definite opinions about whether the Sox should trade slugger Manny Ramirez. Here are 10 podcasts to tune in the next time you need a sports talk fix. They can be found at the Web sites listed or at podcast clearinghouses podcastalley.com, podcast.net, and itunes.com.

By Mark Hyman

PODCAST / WEB ADDRESS / LENGTH	DESCRIPTION
ASK CAL Baltimoresun.com **3 minutes**	Former big league ballplayer Cal Ripken Jr. has become a youth sports guru, dispensing advice on how to choose a coach and the best way to console a distraught child after a tough loss. On a recent podcast, a speaking version of his weekly letters column for the *Baltimore Sun*, Cal explains that it' fine to just say no when a child pleads to play on m than one sports team per season.
BIKETALK RADIO biketalkradio.com **30 minutes**	The next best thing to hitting the open road is talking about the next biking adventure. This podcast, which also airs on a radio station in Davis, Calif., offers reviews of biking books and advice on shopping for new wheels at the local bike club swap meet. Be advised: Some topics are geared to listeners livin within 20 miles of the studio.
FOOTYTALK footytalk.com.au **30 minutes**	Can't get enough Australian Rules Football? This podcast from Down Under is right up your eucalyptus tree, mate. Hosts "Disco" and "The Explosion" are hilarious as they debate the latest player moves of the North Melbourne Kangaroos. Much of the banter lost on me. Still, the hosts' accents are reason enough to listen.
GOLF GEAR NEWS golfgearcenter.blogspot.com **20 minutes**	A newsy, offbeat podcast that blends golf headlines with regular features such as golf for women and interviews with obscure and overlooked equipment manufacturers. The day I tuned in, I even got the lowdown on Annika Sorenstam's new boyfriend. Betting this podcast isn't a fave of Callaway and Titleist lawyers. Its top sponsor is an outfit called golfknockoff.com.
LAXCAST laxcast.com **7 minutes**	If you have to ask who Gary Gait is, this podcast for lacrosse mavens won't appeal to you. Hard-core fans, though, will approve of on-the-spot coverage of pro lacrosse, including an interview with Gait, the gar biggest star, and informative reports from last spring's NCAA lacrosse championship.
RUNNING INJURY FREE Leigh.org/running **5 minutes**	Host and founder Allen Leigh, an avid and thoughtful runner based in Utah, gets right to the point in his no-frills podcasts devoted to subjects such as stretching muscles and tuning your running pace. Leigh's 33 years of running yield many helpful insights to his podcasts. Too bad he doesn't unlace his shoes a produce them more often.
RADIO FREE SPORTS news-record.com **20 minutes**	A panel of wise-cracking reporters from a Greensboro, N.C., newspaper tell the whole truth about Atlantic Coast Conference basketball and other Carolina sports topics. During a recent podcast, the scribes skewered at least four ACC coaches and offered solid analysis of games from Chapel Hill Durham. Consult these smart guys before placin your Final Four bet.
SPORTS BUSINESS RADIO sportsbusinessradio.com **1 hour**	Don't tune in to this weekly podcast—new programs post each Saturday—for breaking sports biz news. But the knowledgeable co-hosts inform and entertain as they bat around details of the latest superstar holding out for an extra million bucks. Guests su *USA Today*'s Christine Brennan and Darren Rove ESPN.com add insights.
SPORTS COMMENTARY BY FRANK DEFORD npr.org **5 minutes**	The *Sports Illustrated* senior writer and prolific author is the poet laureate of American sportswriting. This podcast is a replay of his sometimes biting, often laugh-out-loud pieces for National Public Radio's *Morning Edition*. If you already listening to Deford on your radio Wednesday mornings, these will be of no use.
WITHOUT A CURSE redsox.mysportsradio.com **11 minutes**	Precocious seventh-grader Alex Reimer is host of this podcast for Boston Red Sox fans, and is a celebrity of sorts for his baseball smarts and chutzpah. (Every podcast opens with audio from his appearance on *The Tonight Show with Jay Leno*.) Although his is impressive, Alex occasionally acts his age (13 asked a guest: "Were all the guys [working on a show] nice guys?" He may be the next Bob Cost

TED BY MONICA GAGNIER

AR

D-IT-HERSELF, STYLE

TY GLASSES are getting stylish to the growing ranks of female do-it-selfers. AOSafety, the largest maker otective eyewear, now has a line and styled for women. Clear ons for use indoors, with a around polycarbonate lens and red, or purple temples, are $10. The $15

or models have tinted, mirrored . Called AOSafety Select, they're at aosafetyselect.com and at Ace vare, Home Depot, and Orchard y stores. *–Larry Armstrong*

RENCIES

ONA OANER

OTHER CASE of "when rates of look too good to be true, they prob- e." EverBank.com, an online bank ers foreign-currency accounts to ual investors, launched three- certificates of deposit denominated ndic krona in late November. Why ? High interest rates there allow an 8.24% annual yield, nearly that of dollar CDs. EverBank Markets President Chuck Butler e CDs attracted "tens of millions," pany's most successful launch. e CD owners may be surprised. In ruary, the krona plunged 6% over s about the nation's credit rating. l will put many CDs under water, ing on the exchange rate when was issued. Butler says he isn't d by the market volatility since is a small country with a thinly urrency. "We picked three- naturities because we wanted o have a chance to look and see oing on," Butler says. It's not a ght. *–Lauren Young*

ANNUITIES

Live Long, Prosper

CONVERTING PART OF YOUR retirement nest egg into an annuity may be a better deal than is commonly believed, says a new study by professors from the University of Virginia and Boston College. An annuity guarantees payments for the rest of your life. So the longer you live, the better for you—and the worse for the issuer, which is usually a life-insurance company.

Economists Leora Friedberg of UVA and Anthony Webb of Boston College's Center for Retirement Research say insurers that use a common longevity forecasting tool called Projection Scale AA are probably underestimating increases in longevity and thus could be paying annuity owners some 10% more per month than is truly warranted. Of course the overpayment could be less than that if insurers using Projection Scale AA are building a little more profit margin into their pricing.

Still, Webb says the research is more evidence that annuities make sense for couples afraid of outliving their assets. For a 65-year-old couple today, there's a one-in-five chance that at least one of them will live to 95. *–Peter Coy*

TIME OFF

THE STUDIO WHERE regionalist artist Grant Wood painted the iconic *American Gothic* will be the focus of a Smithsonian American Art Museum exhibit from Mar. 10 through July 16 in Washington (americanart.si.edu/renwick/index.cfm). The show features 160 pieces, including decorative artwork, photos of Wood's studio, and props he used for his paintings. *American Gothic* is not in this show. It hangs at the Art Institute of Chicago.

BY GENE G. MARCIAL

THAT POUNDING AMAZON SHARES TOOK LOOKS TEMPORARY.

SOARING COMMODITY CHIP DEMAND LIFTS TEXAS INSTRUMENTS

SWISS CROP GIANT SYNGENTA EYES A FUTURE IN BIOFUELS.

Low Tide for Amazon?

ARE THINGS REALLY AS GRIM at Amazon.com (AMZN) as some on Wall Street believe? Its shares have been hammered since Feb. 2 when the giant online retailer said 2006 results could be less than analysts were forecasting. The stock, which hit a 52-week high of 50 in mid-December, fell from 45 to 37, where it still sits in the wake of the announcement. "As usual, the Street overreacted," asserts Dave Young of Paragon Wealth Management, which owns shares. Amazon's technical and fundamental characteristics remain attractive, says Young. On price-to-book value, cash flow, and earnings yield, Amazon looks solid, he adds. And after its sharp fall, Amazon stock is in a "low-risk zone," from which it usually ends up scoring an average yearly gain of more than 85%, says Young. Ivan Feinseth, research chief at Matrix Investment Research, has upped his rating from "hold" to "buy" since the drop. He describes Amazon as a "superstar" among the "classic growth" companies based on its "strong economic profitability," solid balance sheet—with free cash flow of $4.24 a share—and "impressive sales gains." Feinseth puts Amazon's "intrinsic value" at $45 a share. Value Line's Warren Thorpe urges long-term investors to hold the stock. He figures the current price is a "good entry point" because the stock "offers attractive capital-gains potential out to the end of the decade." He sees 2006 earnings of 85¢ a share on sales of $10.2 billion, vs. 79¢ on $8.5 billion in 2005.

Texas Instruments: In Electronic Paradise

TEXAS INSTRUMENTS' (TXN) cheap semiconductors have put it in a sweet spot as global demand for low-cost phones and digital TVs explodes. Jeffrey Kleintop, chief strategist at PNC Advisors, which owns shares, now at 32, says that the chipmaker stands to gain significantly over the next three years because of a federal mandate that all TVs produced from 2009 onward must be digital. Kleintop says that will keep TI's sales volumes growing fast and margins soaring. TI reached management's targeted gross margin of nearly 50% in 2005, vs. 2004's 45%. It's a leader in a number of important product groups, he notes, such as digital signal processors (DSPs). The DSP market has grown rapidly because of strong demand for wireless phones, modems, and computer network gear. Tom Smith of Standard & Poor's, who rates TI a five-star "strong buy," says it is profiting from a brisk demand in many chip categories, enhancing its long-term prospects. He expects it to earn $1.50 a share in 2006 and $1.90 in 2007, vs. 2005's $1.39. Smith's 12-month stock price target: 40.

How Syngenta's Garden Grows

ALTHOUGH IT IS A BIG GLOBAL player in seeds an crop protection, Switzerland's $16 billion market c Syngenta (SYT) gets scant attention on the Street. its American depositary receipts have shot from 20 in mi August to 28. Thomas Gilbert of UBS in Switzerland (wh has done banking for Syngenta) figures the stock has mo upside: His price target is 37. He sees Syngenta earning $ a share in 2006 and $11.52 in 2007 (before special charg vs. $8.46 in 2005. Some 78% of the company's total 2005 sales of $8.1 billion in more than 90 countries comes from herbicides, insecticides, and fungicides, and the rest from seeds. Crop protection is a $35 billion market, says Chief Financial Officer Domenico Scala. Syngenta, he notes, has $700 million in free cash flow, part of which will be used for share buybacks. Scala also says one of the company's new focuses will be in producing ethanol-based biofuels: It filed results of pilot trials with the U.S. Agriculture Dept year. Already, a European Union law requires member countries to raise biofuel use to 5.75% of consumption b 2010 from 2% in 2005. Among Syngenta's big rivals are DuPont, Monsanto, Dow Chemical, and Bayer. ■

BusinessWeek online Gene Marcial's Inside Wall Street is post businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street no firms hold positions in the stocks under discussion. Similarly, they have no inve banking or other financial relationships with them.

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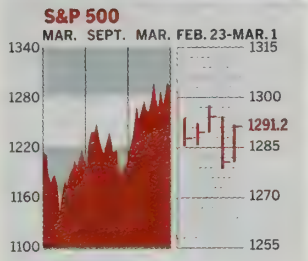
Personal Business Figures of the Week

STOCKS



COMMENTARY

The slowdown in sales of new and existing homes, and the record backlog in unsold new homes, sent stocks lower on Feb. 27-28. Jittery investors were further unnerved by Google's CFO, who suggested growth was slowing; the remarks sent the NASDAQ lower on Feb. 28. Markets recovered, however, on Mar. 1, on reports showing that consumers continue to spend.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	MAR. 1	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1291.2	-0.1	3.4	6.7
Dow Jones Industrials	11,053.5	-0.8	3.1	2.1
NASDAQ Composite	2314.6	1.4	5.0	11.8
S&P MidCap 400	785.2	0.7	6.4	16.8
S&P SmallCap 600	382.1	0.9	9.0	15.0
DJ Wilshire 5000	13,019.6	0.1	4.2	9.2
SECTORS				
BusinessWeek 50*	764.0	0.3	3.0	5.0
BW Info Tech 100**	390.1	1.2	2.5	7.6
S&P/Citigroup Growth	610.4	-0.1	2.3	4.8
S&P/Citigroup Value	677.4	-0.1	4.6	8.7
S&P Energy	396.1	0.1	6.3	15.3
S&P Financials	438.9	-0.6	2.9	9.2
S&P REIT	168.2	-0.4	9.9	23.0
S&P Transportation	265.6	0.5	6.3	16.0
S&P Utilities	163.9	-0.4	2.7	11.2
GSTI Internet	194.4	-0.9	-5.2	22.3
PSE Technology	883.8	1.0	5.7	17.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	MAR. 1	WEEK	% CHANGE YEAR TO DATE
Mexico City (IPC)	19,058.7	1.5	7.1
Tokyo (NIKKEI 225)	15,964.5	1.2	-0.9
Hong Kong (Hang Seng)	15,818.1	1.2	6.3
Toronto (S&P/TSX Composite)	11,794.6	0.0	4.6
Frankfurt (DAX)	5866.6	0.1	8.5
London (FT-SE 100)	5844.1	-0.5	4.0
Paris (CAC 40)	5057.6	0.3	7.3
S&P Euro Plus (U.S. Dollar)	1479.4	-9.1	-2.1

FUNDAMENTALS	FEB. 28	WEEK AGO
S&P 500 Dividend Yield	1.80%	1.78%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.9	18.0
S&P 500 P/E Ratio (Next 12 mos.)*	14.9	15.0
First Call Earnings Revision*	-2.01%	-2.00%

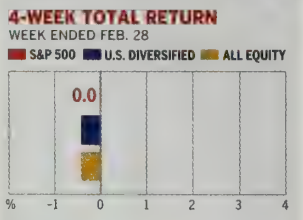
*First

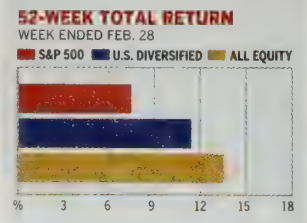
TECHNICAL INDICATORS	FEB. 28	WEEK AGO
S&P 500 200-day average	1231.9	1228.9
Stocks above 200-day average	66.0%	65.0%
Options: Put/call ratio	0.73	0.71
Insiders: Vickers NYSE Sell/buy ratio	4.85	4.34

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Photographic Products	11.0	Oil & Gas Equipment	53.0
Insurance Brokers	8.8	Oil & Gas Refining	51.1
Intgrd. Telecmms. Svcs	7.3	Specialized Finance	47.5
Environmental Services	7.3	Fertilizers & Ag. Chems.	47.1
Building Products	6.6	Human Rsrcs. & Emplmnt.	45.7

WORST-PERFORMING GROUPS	LAST MONTH %	
Internet Retailers	-15.6	Automobiles
Gold Mining	-14.5	Home Entnmnt. Software
Divsfd. Metals & Mining	-14.0	Diversified Chemicals
Automobiles	-13.1	Auto Parts & Equip.
Educational Services	-12.6	Photographic Products

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Communications	1.9	Latin America	64.9
Real Estate	1.7	Precious Metals	46.3
Health	1.6	Diversified Emerg. Mkts.	36.9
Financial	1.5	Japan	31.4
LAGGARDS		**LAGGARDS**	
Natural Resources	-8.7	Domestic Hybrid	6.8
Precious Metals	-6.1	Miscellaneous	8.0
Japan	-4.1	Large-cap Blend	8.1
Diversified Pacific/Asia	-2.0	Large-cap Value	8.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFds. Sh. Prec. Mtls. Inv.	14.5	ING Russia A	81.0
ProFds. Sh. Oil & Gas Inv.	9.5	ProFunds Ultra Japan Inv.	77.0
ProFds. UltTelcmms. Inv.	9.0	iShares MSCI Brazil Idx.	75.8
Janus Asp. Life Scncs. Srv.	8.6	T. Rowe Price Latin Am.	72.2
LAGGARDS		**LAGGARDS**	
ProFunds Precs. Mtls. Inv.	-20.2	Ameritor Investment	-66.7
PowerShares Oil & Gas Svcs.	-14.6	American Heritage Grth.	-42.9
Ameritor Investment	-14.3	Potomac Sm. Cap/Sh. Inv.	-25.8
Fidelity Select Nat. Gas	-13.7	ProFds. USh. Sm. Cap Inv.	-25.0

INTEREST RATES

KEY RATES	MAR. 1	WEEK AGO
Money Market Funds	4.05%	4.03%
90-Day Treasury Bills	4.60	4.57
2-Year Treasury Notes	4.70	4.67
10-Year Treasury Notes	4.59	4.52
30-Year Treasury Bonds	4.56	4.48
30-Year Fixed Mortgage †	6.10	6.16

†BanxQu

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-Y
General Obligations	3.82%	
Taxable Equivalent	5.46	
Insured Revenue Bonds	3.91	
Taxable Equivalent	5.59	

THE WEEK AHEAD

FACTORY INVENTORIES *Monday, Mar. 6, 10 a.m. EST* » Manufacturing inventories most likely rose 0.5% during January. In December, stocks also grew 0.5%.

INSTALLMENT CREDIT *Tuesday, Mar. 7, 3 p.m. EST* » Consumers are forecast to have accumulated an additional $5 billion of debt in January. That's the median forecast of economists surveyed by Action Economics. In December consumer credit grew by $3.3 billion, and the full-year increase of $62.5 billion was the smallest since 1993.

INTERNATIONAL TRADE *Thursday, Mar. 9, 8:30 a.m. EST* » The January foreign trade deficit probably hit $67.1 billion. In December the trade gap grew to $65.7 billion despite a 4% decline in crude-oil imports.

EMPLOYMENT *Friday, Mar. 10, 8:30 a.m. EST* » Nonfarm payrolls in February are expected to have expanded by 200,000 workers; 93,000 jobs were created in January. Strong demand probably led manufacturers to hire 5,000 more workers. Even with the new jobs, the unemployment rate most likely held at 4.7%.

FEDERAL BUDGET *Friday, Mar. 10, 2 p.m. EST* » The federal government most likely posted a budget shortfall of $118 billion in February, following a $21 billion surplus in January.

The *BusinessWeek* productic fell to 270.2 for the week er Feb. 18, but stood 13.9% ab year-ago level. Before calcul the four-week moving avera index retreated to 269.6.

BusinessWeek o

For the BW50, more invest data, and the components of the production index vis www.businessweek.com/magazine

ne Companies

ndex gives the starting page for a story or feature with ificant reference to a company. Most subsidiaries dexed under their own names. Companies listed only es are not included.

) 76
ware 95
) 50

's (ABS) 56
t Media 44
com (AMZN) 96
) 30, 76
95
nagement 56
PL) 53
2
al 56
Razorfish 46
6

C) 51
nerica (BAC)

) 96
ng 53

Coulter (BEC)

Group 56
) 32, 62
Sox 94
ay Carret 84
Enterprises

56
Northern

50
3, 46, 76
) 56
CD) 56
nobile 60
ns (CSCO)

51, 58
s (CLE) 84
3

CNN (TWX) 30
CNOO (CEO) 60
Coca-Cola (KO) 42
Colgate-Palmolive (CL) 30
Colony Capital 32
ConsumerLab.com 18
Converse (NKE) 26
Corporación Interamericana 51
Creative Technology (CREAF) 53
CreditSights 56, 58
Credit Suisse (CSR) 32
CSX (CSX) 32

D

DaimlerChrysler (DCX) 30, 32, 51
Dell (DELL) 42, 46
Deutsche Bank (DB) 30
Dieste Harmel & Partners (OMC) 80
Digium 78
Dow Chemical (DOW) 96
DreamWorks 30
Dubai Ports World 30, 32
DuPont (DD) 42, 96, 100

E

Ebookers (CD) 56
Emaar Properties 32
Emirates 32
Endesa (ELE) 30
Enel (EN) 30
Energizer (ENR) 80
Energy Security Analysis 38
Engage In-Game Advertising 18
E.ON (EON) 30
ESPN 46, 76
EverBank 95
Evercore Partners 56

F

Fair Isaac (FIC) 44
Fairmont Hotels (FHR) 32, 56
FanLib 26
Ferrari (FIA) 32
Fluor (FLR) 32
Ford (F) 30, 51, 100
Fox Sports (NWS) 80
FreshPlaza 14
Fujitsu (FJTSY) 50

G

Gartner Dataquest 53
Gas Natural 30
Gaz de France 30
Geely Auto 60
General Electric (GE) 30, 32, 51, 62
General Motors (GM) 30, 51
GimmeCredit 56
Goldman Sachs (GS) 58
Goodby Silverstein (OMC) 80
Google (GOOG) 43, 44, 76
Grupo Gallegos 80

H

Haier Group 60
Harley-Davidson (HDI) 60
Hewlett-Packard (HPQ) 32
Hoefer & Arnett 43
Home Depot (HD) 95
Honda (HMC) 30
Hughes Supply (HUG) 42

I

IBM (IBM) 22, 60, 78
IDG Ventures 50
IFR Markets 38
IGA Worldwide 18
Innobase Oy 78
Intel (INTC) 50
International Strategy & Investment 42
iSuppli 53

J

Jaguar Cars (F) 30
Jarrow Formulas 18
JasperSoft 78
JBoss 78
Johnson Asset Management 56
JPMorgan Chase (JPM) 27
Jumeirah 32

K

KeySpan (KSE) 30
Kingdom Holdings 32

L

La Quinta 56
Laureate International 52
Lehman Brothers (LEH) 56, 58
LendingTree (IACI) 26
Lenovo (LNVGY) 60
Limited Brands (LTD) 50
Lockheed Martin (LMT) 62

M

Mark Burnett Productions 76
Marriott (MAR) 46
Matrix Investment 96
Mattel (MAT) 14
Maxtor 22
Maytag (MYG) 60
McGraw-Hill (MHP) 58
McKinsey 62
Memeo 22
Merrill Lynch (MER) 58
MGA Entertainment 14
Microsoft (MSFT) 32, 42, 76, 78
Monsanto (MON) 96
Moody's (MCO) 58
Morgans Hotel (MHGC) 18
Morgan Stanley (MS) 13, 32, 42
Motorola (MOT) 50
MSN (MSFT) 76
MTV (VIA) 18
Mumbadala Development 32

N

National Grid (NGG) 30
NBC 76
Netgear (NTGR) 22
Nidec 50
Nike (NKE) 50
Nissan (NSANY) 30
Nortel (NT) 50
Novell (NOVL) 78
NPD Intellect 53

O

Oracle (ORCL) 78
Orascom Telecom 32
Orbitz (CD) 56
Orchard Supply 95

P

P&O 30, 32
Paragon Wealth Management 96
Paramount Pictures 30
PepsiCo (PEP) 26
PFC Energy 32
PNC Advisors 96
Porsche (PSEPF) 30
PricewaterhouseCoopers 27
Procter & Gamble (PG) 30, 50, 62

Q

Qatar Airways 32

R

Ramada (CD) 56
Rambus (RMBS) 42
Red Hat (RHAT) 78
Ritterbusch 38
Ryan Beck (BBX) 84
Rydex Investments 42

S

Saks Fifth Avenue (SKS) 26
Sam's Club (WMT) 51
Samba Financial Group 32
SanDisk (SNDK) 53
Showtime (CBS) 26
Sirius Satellite Radio (SIRI) 13, 76
Skidmore Owings & Merrill 32
Sleepycat Software 78
SMS Consumatori 14
Sony (SNE) 53
Southwest Airlines (LUV) 80
Sparton (SPA) 50
Spartronics Vietnam 50
Standard & Poor's (MHP) 42, 43, 56, 58, 96
Stanley Works (SWK) 58
State Street Global (STT) 42
Stifel Nicolaus 43
Straszheim Global 60
Subway Restaurants 18
Suez (SZE) 30
Sumitomo 32
Sun Microsystems (SUNW) 78
Superfund Group 18
Suzuki 30
Syngenta (SYT) 96

T

TCW Small Cap Growth Fund (TGSCX) 42
Ted's Montana Grill 30
Tesco 42
Texas Instruments (TXN) 96
Thomson Financial (TOC) 56
3M (MMM) 62
Time Warner (TWX) 30, 46
Toyota (TM) 30
Turner Construction 32
TXU (TXU) 30

U

UBS (UBS) 32, 42, 96
Universal Pictures 30
Univision (UVN) 80
Unocal (CUX) 60

V

Value Line (VALU) 96
Valve 18
VeriSign iDefense 44
Viacom (VIA) 32
Virgin Mobile 80
Volvo (F) 30

W

Wachovia (WB) 58
Wal-Mart de Mexico (WMMVY) 51
Wal-Mart Stores (WMT) 42
Wells Fargo (WFC) 58
Whole Foods (WFMI) 30
Wind 32
Wyndham International 56

Y

Yahoo! (YHOO) 13, 44, 76

It *Is* Who You Know

PULL Networking and Success since Benjamin Franklin
By Pamela Walker Laird; Harvard University Press; 439pp; $29.95

Whatever happened to the self-made man? According to Pamela Walker Laird, he—or she—never existed. Sure, individual talent and initiative matter. Yet Laird believes office grumblers are also on the right track when they complain that someone succeeded due to "connections" or that a dearth of women or minority managers is due to bias. What was long missing from historians' efforts to understand success, she argues, was a way of thinking embodied in an appropriate vocabulary: mentoring, networking, role modeling, gatekeeping. Laird, who admits these words have become a bit shopworn, says the terms' late-20th-century emergence has enabled a new understanding of the workings of upward mobility in America.

In *Pull: Networking and Success since Benjamin Franklin*, Laird offers an illuminating analysis of how exceptional achievers have combined individual talent with social assets in order to rise in society. The author, a historian at the University of Colorado at Denver, provides capsule biographies of such legendary successes as Franklin, Andrew Carnegie, J.P. Morgan, and Bill Gates. She also considers the history of those who have been shunted aside, notably women and African Americans, along with their attempts to fabricate social networks and get around exclusionary gatekeepers. If you're like me, these accounts will often have you murmuring "I didn't know that." But be forewarned: Laird's volume is academic, blessed or cursed, according to your point of view, with writing and a structure appropriate to that universe.

The case of Carnegie is instructive. As a Scottish immigrant growing up in the slums of Pittsburgh in the 1840s, young Andy wouldn't seem to have had much in the way of connections. But via family ties, the youth found a post in a telegraph office, and there his eagerness and charm won the attention of Thomas Scott, soon to be the superintendent of the Pennsylvania Railroad's western division. At each step on his rise to the top of that railroad's hierarchy, Scott brought along his young protégé. Scott, who "quickly became the center of Carnegie's professional world and remained there for years to come," would be the most important of many men, older and younger, who fostered Carnegie's career. The term didn't exist at the time, but Scott was in fact a mentor. To Carnegie, he was merely "my great man."

Such informal mechanisms were no longer adequate c organizations became larger and more complex. So, in th early 20th century, corporations began to develop more formal personnel departments and standardized process recruitment, hiring, training, and promotion. More and the educational system served as a gatekeeper, with the c scorned college degree becoming, by the 1950s, a prereq for entering management ranks. Meanwhile, social netw gender, race, and intangibles such as "likability" or perc "potential" continued to determine whether doors open slammed shut. This was particularly the case at the high rungs of the ladder: Laird details how, beginning in 1919, in a transition away fr family operation, DuPont executives groo future President Walter S. Carpenter Jr., "whose intertwining of personal and bus ties combined to make him a comfortabl surrogate heir."

The author devotes considerable spac reviewing the halting steps by which Afr Americans and women advanced within Business. The 1964 Civil Rights Act disa "an entire system [of social capital] and traditions of distributing opportunity." law banned only "push discrimination," outright exclusion. Very quickly some sa more would be required, especially to dr disadvantaged into the system. Thus affirmative action was born, an approac author refers to as "synth social capital." By 1968, F Motor announced that it be aiming "not to screen doubtful applicants but t screen in if possible," tur push to pull. But many A Americans and women p poohed this approach, ins that all they would need t ahead was an equal chan

> America's top achievers have always leveraged talent with social assets

Time proved them wro led to new ways of thinki Laird tracks the emergen such concepts as the glass ceiling, mentoring, and networking to the efforts of women, beginning in the 1 to penetrate barriers. By the end of the 20th century su mechanisms were widely appreciated. Even as the acti that inspired them began to fade from memory, the wo became commonplace. "Mentors, networks, and role n now populate the index of every management book an how-to-succeed treatise," notes Laird. In today's versi Horatio Alger literature, even self-made men have ment

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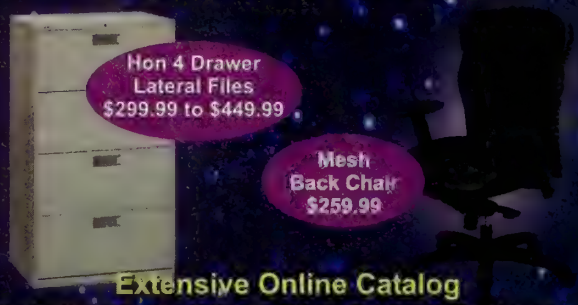

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Ideas The Welch Way

BY JACK AND SUZY WELCH

Strategy for Small Fry

What do you see as the strategic essentials for companies employing fewer than 100 people? Recommendations from academics and consultants apply almost exclusively to large corporations, drowning us in a sea of advice that feels irrelevant for small organizations with constrained resources.

–Thomas Box, Pittsburgh, Kan.

We have bad news for you. Strategy is strategy, whether the company is large or small. It's that killer idea, a "big aha," as we call it, that gives you a sustainable competitive advantage. Put another way, strategy is just a winning value proposition, a product or service that customers simply want more than the other options out there. Beyond that, strategy is all about execution. And there, small companies actually have something of an advantage.

We don't blame you for feeling as if most advice on strategy applies mainly to big companies. It's just so complex, as if strategy were rocket science. In fact, with all the number-crunching and data analysis being promoted as strategy these days, you'd have to be a large company to have the people, time, and money to even contemplate such methodologies.

Don't bother trying. The more you grind down into details and scenarios, the more you get tied up in knots. Look, once you have your big aha, strategy is just an approximate course of action that you revisit and redefine according to shifting market conditions. It's got to feel fluid—and alive!

Companies small and large can develop a compelling strategy by answering five key questions. What does the playing field look like? What are our rivals up to? What have we done lately? What keeps us up at night? And, given all that, what's our winning move?

No academic textbooks or consultants are needed. All that's required is a team of engaged employees who can dream big, debate intensely, and ultimately emerge with a dynamic game plan. Then it's time to implement, and that's where small companies really have it made. When there are only a hundred employees, or even a thousand, it is much easier to communicate strategy and ignite a contagious intensity. And once the strategy is launched, small companies, like little powerboats, are able to adjust direction more quickly than corporate ocean liners. They can also hire faster, make decisions with fewer bureaucratic hurdles, and generally see their mistakes (and fix them) faster than hulking competitors.

That said, small isn't totally beautiful when it comes to strategy. Here's the rub: With constrained resources, you have to be right more often. Big companies can take a lot of s and miss a few. By contrast, one big strategy mistake ca a small company out of business.

The imperative for small companies, then, is to hold t value proposition to a higher standard. They have to ma sure they've got something singular: a new idea with a p a breakthrough technology, a super-low-cost process, or unique service offering. Whatever attracts customers an makes them stick. When a small company gets to that p can celebrate a strategy that's winning without all those consultant reports, graphs, and fat stacks of PowerPoint that no one really needs, not even the big guys.

> Once you have your killer idea, all you need is an approximate course of action

Career development articles always say: "Find a good me What advice do you have for getting someone like Bill Clin Warren Buffett to meet for even 30 minutes with a 24-yea

–Stephen J. Pomeroy, Ne

You're barking up the wrong tree. No doubt both Mr. Cl and Mr. Buffett would give you profound insights into l succeed in life and work. But a mentor isn't a luminary 30 minutes to spare. Frankly, a mentor isn't even a VIP executive at your own company with an hour allotted ju you every other week.

Or it might be, as long as you have lots other mentors. And that's our point. The a important mentor—the Delphic Oracle of advice—is too limiting. You want everyon a mentor in one way or another, teaching whatever they know that you don't.

Many companies, of course, don't appr mentoring with this mindset. Instead, the sponsor formal programs in which bright things are linked with older-and-wiser ty regularly scheduled meetings. Devoid of chemistry, such manufactured relationshi too often valuable mainly for directions t lunchroom. The best mentoring relation are informal, forged not only with higher but also with peers and subordinates. Wh we're saying is that while getting on the calendars of the world's leading lights would be great—more power to y good ideas are everywhere. Every time you find one, you yourself another mentoring experience.

Jack and Suzy Welch are co-authors of the best-seller Winnir *(HarperCollins 2005). They look forward to answering your questions about business, company, or career challenges. Please e-mail them at* **thewelchway@businessweek.com**

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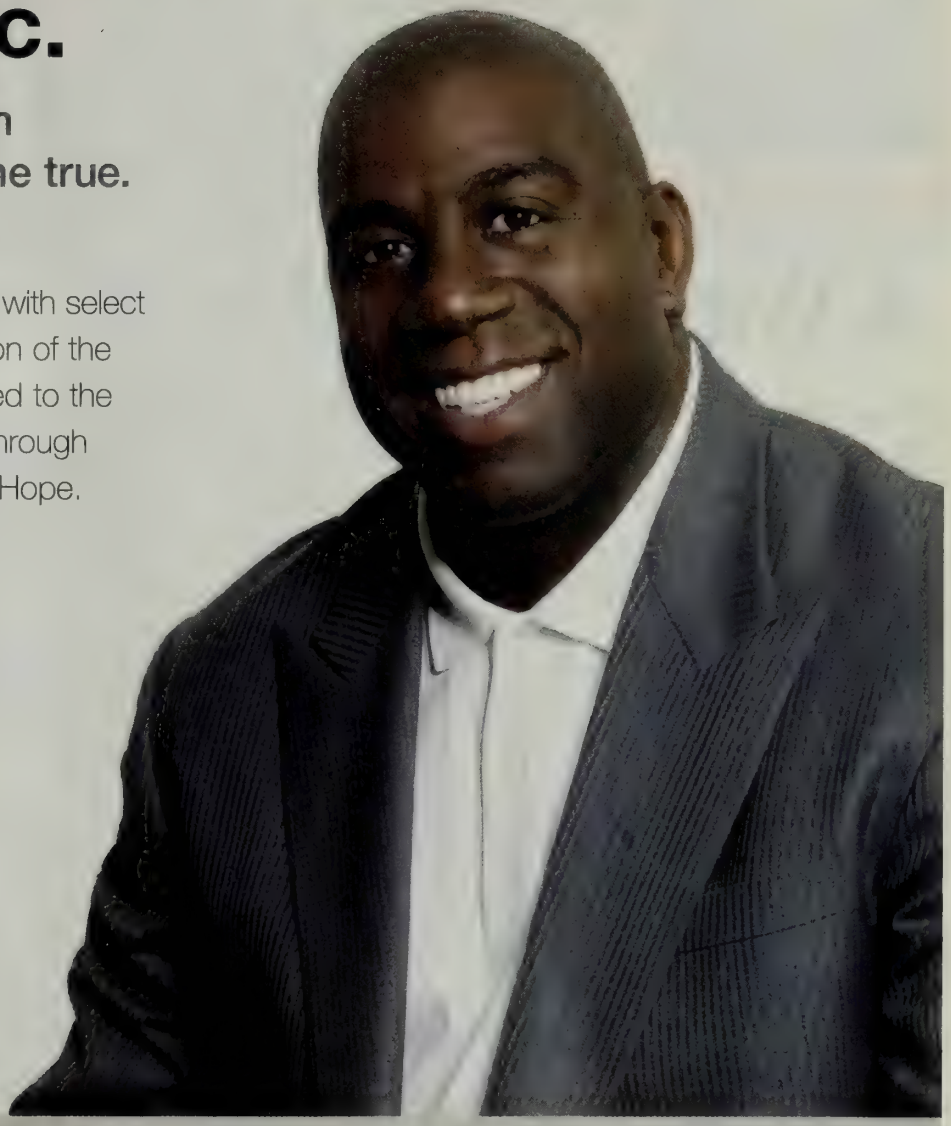

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IdeasOutside Shot

WILLIAM W. BEACH

A Way to Test-Drive Tax Policy

One of the most significant initiatives of President George W. Bush's 2007 budget proposal has gone virtually unnoticed. And no wonder: How could a move to improve the way the federal government analyzes tax policy compete with news about cutting outdated programs, making the U.S. more competitive, and winning the global war on terrorism?

This little-noted initiative, however, may be historically important. Buried deep in the President's proposals for the Treasury Dept. is a plan to create a Dynamic Analysis Div. within the Office of Tax Analysis. This unit would advise the President and key policymakers on how proposed changes to U.S. tax laws would affect economic activity. Inside the Beltway, this type of work is called "dynamic analysis." Outside the Beltway, this is called "economics."

So why is this news? Hasn't the government been studying the effects of tax policy on the economy all along? (That's the dynamic analysis part.) And aren't Washington policymakers routinely advised about how tax changes will affect jobs and output and how those, in turn, will affect government revenues? (That revenue-estimating function is called dynamic scoring.)

Surprisingly, the answer is often no. Until very recently, no official Washington agency produced estimates of the economic and tax-revenue effects of proposed policies. Congress' official tax-policy scorekeeper, the staff of the Joint Committee on Taxation (JCT), began building this capability a few years ago and since has produced a few dynamic scoring documents. Prior to that, JCT made static estimates or "scores" of how tax changes affect government revenues but didn't gauge effects on the broader economy.

The Congressional Budget Office also recently began publishing estimates of how the President's and Congress' budget plans (which include tax changes) would affect economic activity. However, all of these documents together still fit into a slim file folder. And so far the Treasury Dept. has done almost nothing publicly to contribute to that literature.

UNLESS POLICYMAKERS CAN see that some tax policy changes support more vigorous economic activity while others do not, they may enact laws (indeed, they have) that are at best economically meaningless, at worst downright harmful. Dynamic analysis can help sort the good from the bad.

Take, for example, the child tax credit. Many advocates of the credit (now worth $1,000 per child) argued that it would put money into the hands of consumers, who would spen those funds, thus fueling economic activity. Had those policymakers been advised about the likely economic effe of this tax change, they would have learned that the credi would do nothing to lower the costs of working or investi two of the biggest drivers of economic activity, and that c windfalls almost always are saved, especially by taxpayer with children. There's nothing wrong with saving for a cl education, but it won't lead to the bump in current consumption that advocates of the child tax credit expect

While that credit has not done very much, if anything, today's economy (as dynamic analysis woul have projected), the same cannot be said if were to raise taxes to reduce the federal buc deficit. Advocates of such "revenue enhancements" appear to argue that tax increases won't affect economic activity but growing budget deficits do. Standard mode the economy, however, show that income ta increases harm growth in employment, investment, output, savings, and even proje government revenues. They also show that deficits by themselves have little effect on interest rates. In short, raise taxes to reduc deficits, and the result will be higher unemployment, a slower pace of economic growth, and revenues that don't rise as qui as static scoring predicted.

> The Bush plan would analyze the effects of tax changes on the economy at large

Dynamic analysis and scoring could help prevent bad policy from becoming law. Furthermore, reporting the economic consequences of tax proposals will be enorm helpful in redesigning the tax system. The President has called for fundamental tax reform, and he and Congress find that a much easier exercise if routine and sophistic dynamic scoring is in place whenever the task is tackled

So congratulations to the Bush Administration and to Treasury Dept. This key change in how tax policy is form could well be hidden gold in an otherwise indifferent buc

William W. Beach *is director of the Center for Data Analy at the Heritage Foundation.*

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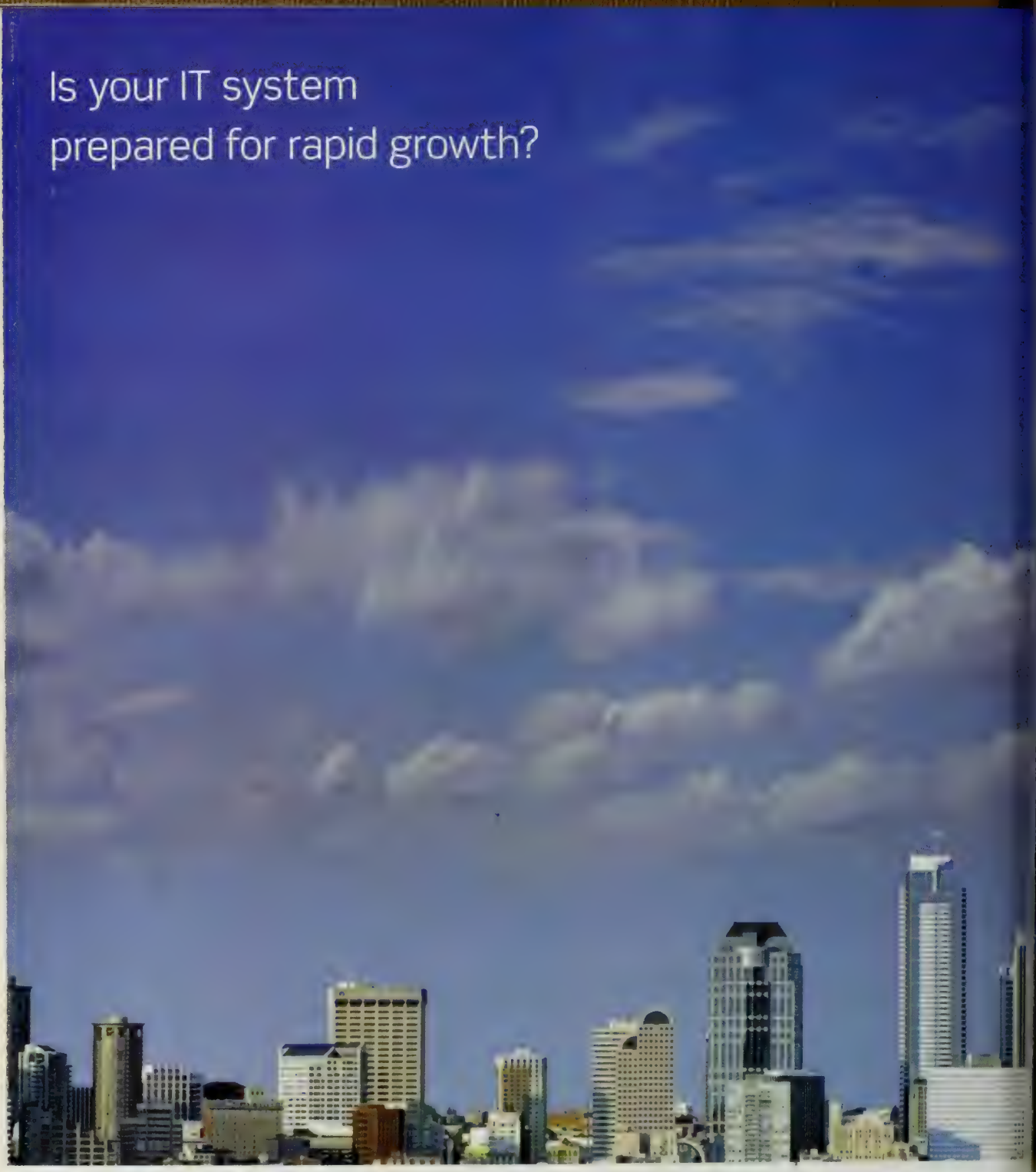

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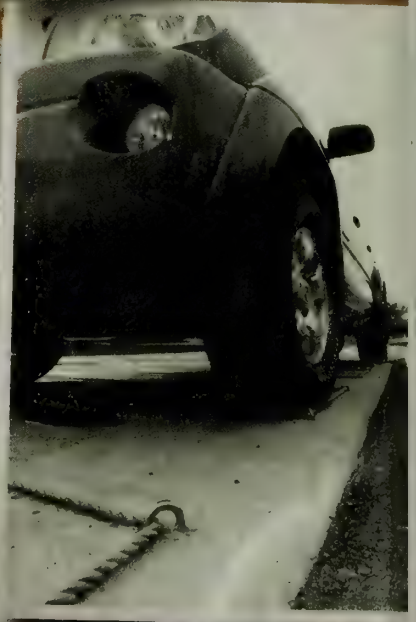

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64
ENDLESS SUMMER
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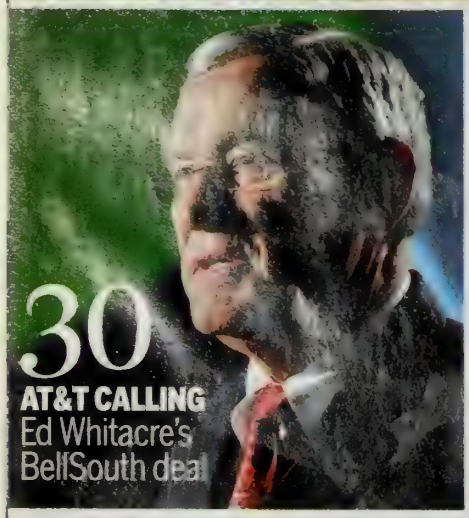

30
AT&T CALLING
Ed Whitacre's BellSouth deal

50
DEBT VALLEY
Cisco, Oracle, and others rethink their balance sheets

Special Report

64 Forever Young
The anti-aging industry feeding the fever to turn back time by selling megadoses of vitamins a supplements meant to prevent the body's orgar from deteriorating. Criti charge that there is no scientific evidence that these costly and largely unmonitored regimens actually work. But busin is downright brisk

70 Legal Tangle at the Fountain of Yo
Did Pfizer illegally market hormone

72 Diet in a Bottle
New elixirs from biotech may exten

74 Ask the H-Scan How Young You A
A BW writer discovers her "real" ag

The Business Week

28 News You Need To Know
Mergers galore; cuts at GM; Fastow sings; bond market blues; and mor

News: Analysis & Commentary

30 Feels Like Old Ma Bell Again
Critcs think AT&T's string of acquisitions gives it too much powe

32 Twilight for Telecom Price Cuts
Why the landscape could change—

34 Battling for the Eyes of Texas
Verizon's TV service is a hit in a For Worth suburb

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ıina: A Billion Tough Sells
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actics on a demanding public

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›ing After Microsoft—for Decades
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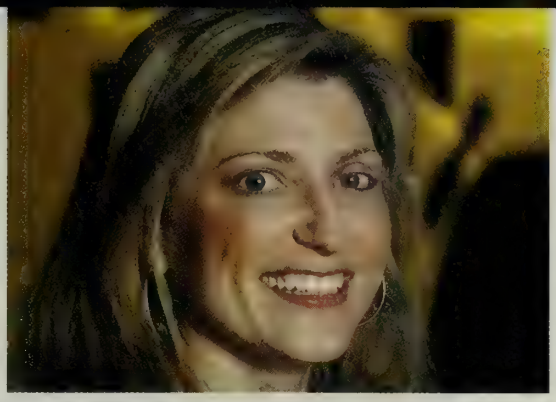

80

TUNING UP CADDY
Liz Vanzura made the Hummer campaign hum. Now she's setting her sights on Cadillac and other GM brands

People

84 The Ultimate Balancing Act
Xerox R&D chief Vandebroek just focuses on what's important

Science & Technology

86 Commentary: Toxic Transportation
Hazardous loads make rails vulnerable

Government

88 It's Hard Out Here for a Lobbyist
A freewheeling meal with liquor, gun, and tobacco lobbyists after a screening of *Thank You for Smoking*

Information Technology

90 No, No, Net
Plenty of folks who aren't old or poor say they have no interest in going online

Personal Business

96 How Much Execs Are Really Paid
Even when companies are more forthcoming, paycheck totals can be hazy

98 Taking Measure of Your Fund Manager
One way to tell if he's earning his keep is to use your fund's old portfolio as a benchmark

102 In India, a Magic Carpet Ride
A rug-buying trip to the source makes for great adventure

104 Personal Business Plus
Lizards in Chicago's aquarium; a gadget that feels your burn; patience and stock splits; what's in a credit rating?

Columnists

22 Wildstrom: Technology & You
Finally, a safer Explorer

24 Grover: Media Centric
From actors to songwriters, everyone in Hollywood has their hands out for the dough from film downloads

25 Cooper: Business Outlook
U.S.: Slower productivity growth and faster unit labor costs could ignite inflation
Exports: A brighter picture for the U.S.

106 Marcial: Inside Wall Street

114 Bartiromo: Face Time
Ed Whitacre on his biggest deal yet

Ideas

112 Books
Pfeffer and Sutton: *Hard Facts, Dangerous Half-Truths & Total Nonsense*

116 Outside Shot: Leo Hindery Jr.
Regulators need to impose some strong limits on an AT&T/BellSouth merger

Voices of Innovation

20 Net Movie Mogul
Mika Salmi's atomfilms.com survived the dot-carnage and is thriving on broadband

Features

11 UpFront
16 Editor's Memo
18 Readers Report
18 Corrections & Clarifications
108 Figures Of The Week
110 Index of Companies

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All Geared Up in Geneva

With its heavy dose of Ferraris, Bentleys, and Aston Martins, t Geneva Motor Show is a posh display of beauty and innovatio But it's also a major battleground in the war for market share in the global auto industry. This **Online Special Report** features the cars and companies that grabbed the spotlight this year, such as **Kia's** new Cee'd, an upmarket compact squarely aimed at unseating the VW Golf as Europe's best-sell car, and the Opel GT roadster, which **GM** hopes will spark a renaissance for its struggling Europe business. Eager to regai some lost ground, Europe stalwarts like **Peugeot** and are fighting back with innovative niche models. And testing the boundarie imagination and brands a such bold new **concept car** a four-seat coupe from Rolls-Royce and Saab's aviation-inspir Aero X. For slide shows, analysis, and more news from Genev go to **www.businessweek.com/go/geneva06**

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UP Front

"This is an opportunity for us to demonstrate that we are not dinosaurs."

–Robert H. McCooey Jr., CEO of Griswold Co. and NYSE member, on the New York Stock Exchange going public on Mar. 8 as reported in USA Today

ED BY DAN BEUCKE

ST DESERTS

R THE FEDS, HITE-COLLAR IME PAYS

AVE of white-collar is paying off. The total ted from confiscated sold or auctioned off **Justice and Treasury** , the two branches andle rty seized h cases, ed to million 05, from million in Last year vernment sold a ston (Tex.) beach house ad belonged to former CFO Andrew S. Fastow 95,000 (above). It got 00 for the 1999 Shelby 1 sports car once by Kenneth Rice, who l Enron's broadband oth men pleaded guilty to securities fraud. On Mar. 23 the feds will auction off Asian rugs and vases from former Representative Randy "Duke" Cunningham (R-Calif.), who pleaded guilty to bribery charges.

Just because the goods are hot doesn't mean buyers get a steal. In January, Los Angeles resident Betty Thomas paid $38,000 at auction for a 2001 **Jaguar XK8** convertible that once belonged to an exec convicted of insurance fraud. That's pretty close to what she would have paid a dealer. Thomas paid no taxes; the **California Motor Vehicles Dept.** tried to collect past registration fees, then backed down. Thomas gets a kick out of driving a criminal's former ride. "I keep thinking, 'I wonder if anyone will recognize it.'"

–Christopher Palmeri

TO-DO LISTS

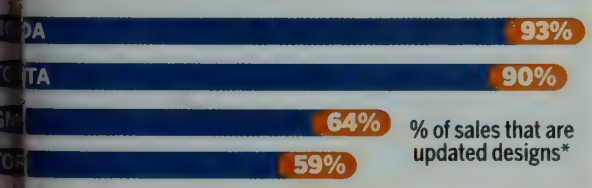
Microsoft's Power Trip

IS MICROSOFT'S next version of Windows a power hog? Two of the company's closest partners say the latest test version of **Windows Vista,** due out this fall, eats 25% more power than the current **Windows XP.** Translation: An average laptop using that version might conk out halfway through a flight from Los Angeles to New York. "The power management features and power draw are in rough shape," says an executive whose company has to mesh its equipment with the software.

That's not to say Microsoft and its partners won't fix the problem before Vista ships. "It's too early to determine precise comparisons," says spokesman Michael Burk. "But we're looking to deliver battery life that is on par with Windows XP." It won't be easy. Vista will offer a lot of eye candy, including 3D graphics and live news headlines. Those suck power. And the SuperFetch feature, which helps programs load faster, could be an oinker, too, depending on a computer's configuration. That's why Microsoft is pushing PC makers to use power-sipping flash memory in laptops. It's also hoping for a technological boost from chip and battery makers. Microsoft has time to fix the issue. Not doing so could mean a serious loss of market power. *–Cliff Edwards and Jay Greene*

BIG PICTURE

LANE Honda Toyota are cted to roll out more new els over the next three years than GM Ford, replacing 90% or more of the cars sell. That should give them an edge.



centage of sales volume attributed to new designs in 2006-09 model years (vehicle replacement rate)
ynch analyst John Murphy

UP Front

CLASS NOTES

MBA FOR HIRE. CAN FILL INSIDE STRAIGHT

POKER IS white-hot on university campuses. Clubs flourish and students claim to be paying tuition, and more, with online winnings. So it's

no surprise that poker skills increasingly turn up on grads' job applications. Gary Fraser, Dean of Students at the **New York University Stern School of Business,** says he's noted an uptick of card playing listed as an interest on students' résumés. Players claim poker helps reinforce important strategic and analytical lessons, such as making decisions with imperfect information and predicting competitor behavior.

But this is one hand you should play carefully, advises Andy Chan, director of the MBA Career Management Center at **Stanford University.** Only list poker as a skill if you're at an advanced level. And be prepared to discuss it with interviewers in a way that seems unique. That's because, as skills go, this one is becoming commonplace: A 2005 study from the Annenberg Public Policy Center of the **University of Pennsylvania** found that 50.4% of college males (and just over a quarter of women) gambled on cards at least once a month. *–Megan Tucker*

UNPLUGGED

TO THE LIST of corporate scandal docudram add *Who Killed the Electric Car?* The 92-min exposé, narrated by Martin Sheen and set fo June release by Sony Pictures Classics, clain big car companies made only token efforts t introduce electrics in the late 1990s. The sag focuses on the short, unhappy life of the EV1, which General Motors produced from 1996 t 2000. Despite rabid fans willing to camp out car lots, EV1s eventually were collected (they were leased, not sold) and scrapped. GM sa too few drivers wanted to plug in and recharg after only 100 miles. "We spent more than $ billion to produce and market the vehicle," sa a spokesman. "Fewer than 800 were leased. *–Christopher Pal*

BLOGSPOTTING

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» **WHY READ IT** This acidly funny "tech gossip rag," part of the Gawker blog network, entertains as it skewers everything Silicon Valley, from newly minted millionaires to product-launch hype.

» **NOTABLE POST** "It's the 'I'm working on a screenplay' of Silicon Valley: Every regular Joe's got a dot-com startup, or at least a great rough draft they've been tweaking forever.... As service journalism to all the would-be startuppers out in the Valley, here's the checklist to confirm that yes, someone else had your idea, and yes, they did it better than you can."

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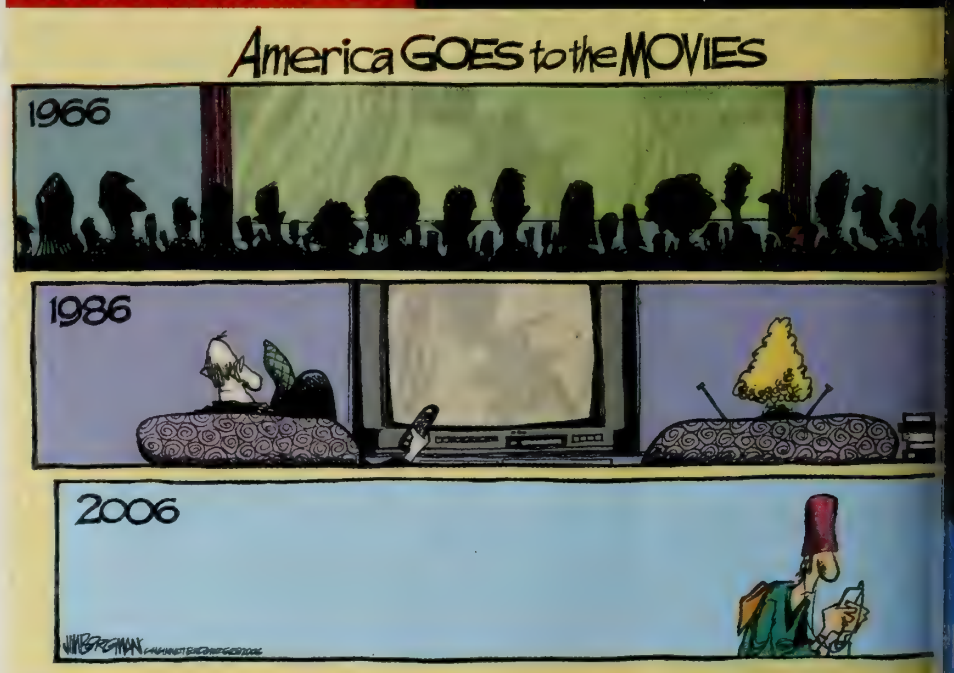

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MEDIA

PORN DOES DIGITAL, AT 10¢ A MINUTE

The porn industry led the way into such new technologies as VCRs and pay TV. Could online micro-billing be next? Adult movie sites are charging users by the minute, as opposed to the subscriptions often charged by paid online media. Richard Cohen, founder of National A-1 Internet, the Philadelphia-based parent of HotMovies.com, says per-minute billing was a natural extension of his core business, phone sex lines. His typical online customer stays on about half an hour, paying 10¢ per minute. "Less than a cup of coffee at Starbucks," Cohen notes.

But there are reasons why this latest porn innovation may not migrate to mainstream media. Cohen and others can charge for a thin slice of an adult movie because people expect to pay for porn. That's not the case with other media, says David Card, a senior analyst at Jupiter Research: "I think charging by the minute is kind of unnatural for Americans. They don't like to watch the timer."

–Christopher Palmeri

WRETCHED EXCESS

IT'S NOT SO EASY TO SHAME A CEO

THE SECURITIES & Exchange Commission hopes that its plan to require better disclosure about pay packages will shame some executives into restraint (page 96). Don't count on it. A wide-ranging study from three professors at **Wharton School** and **Stanford's Graduate School of Business** finds that negative publicity about CEO pay hasn't led to smaller compensation awards. The authors studied more than 15,000 articles written about public companies between 1994 and 2002. They counted mentions of CEO compensation, categorizing them as positive or negative, and analyzed changes in pay for those execs two years after the reports.

The result? Some companies and executives made "cosmetic" adjustments in the options awards or cash pay compared with total compensation. But most CEOs kept their fat pay packages even after being skewered in print. "We didn't find the press had much of an impact," says David Larcker, a Stanford accounting professor.

Call it the Dennis Kozlowski $6,000 shower curtain effect. The study found the press fixates on the paychecks of big-company CEOs, partly for their entertainment value while missing exorbitant pay elsewhere. The press also often fails to adjust for factors such as company performance or the length of time over which stock options were accumulated.

Thus, the study reco six negative articles aft **IBM** head Louis V. Gerst Jr. took home $115 mill from stock exercises in during which IBM's sto price rose 42%. Meanw Gregory Reyes, former of **Brocade Communicati** largely escaped mentio the $370 million he rec in total direct compens that year thanks to a gr more than 10 million st options, as calculated b study's authors using t Black-Scholes formula. Brocade's stock price fe 64% in 2001. The comp declined comment.

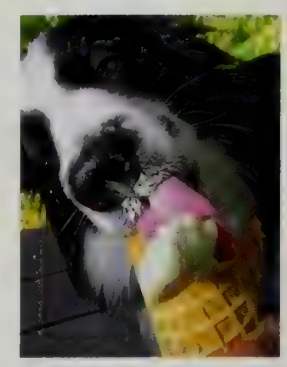
–Elizabeth

PET PROJECTS

HERE, FIDO, TIME FOR YOUR GLUCOSE TEST

LIKE HUMANS, America's cats and dogs are growing fatter. Blame a lack of exercise and too many snacks. And like humans, those four-legged friends have been hit with a diabetes epidemic. An estimated one in every 200 dogs has the disease, and one in every 400 cats, according to veterinary studies. So maybe it's not too surprising that a big drug company, **Abbott Laboratories,** has just brought to market an at-home device to test the blood glucose of pets.

Until now, owners could monitor their pets' conditions by hauling them to the vet or by using a urine test or a blood-kit designed for people. The results of those tests can be wildly inaccurate. Abbott's handheld device, called the AlphaTRAK, is calibrated for cats and dogs. In just 15 seconds, it can gauge sugar levels from a few drops of blood, typically drawn through a pinpri the outer ear.



The diagnostic meter which Abbott is selling through a hospitals, for $80, p for each te strip. That may strain household budgets. B with some million ca dogs in American homes—a many of t apparently eating too w Abbott may not have th market to itself for long

–Michael

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SmallBiz, Big Impact

WHEN WE LAUNCHED *BusinessWeek SmallBiz* in 2004, we kne there was a need for aggressive coverage of small compan and entrepreneurs. The two issues we produced that year were so well received that we moved to a quarterly schedu in 2005. This year we've increased our circulation rate bas from 500,000 to 650,000. And *BusinessWeek* itself has added a monthly feature on entrepreneurs.

Clearly, we're on to something. Reader feedback has been enthusiastic, praising *SmallBiz* for its focus on service and the tough reporting *BusinessWeek* is known for. *SmallBiz*, which won Best Start-Up Publication in the 2005 Jesse H. Neal Awards from American Business Media (as well as the Silver prize for New Publication from the American Society of Business Publication Editors), is up for three Neal Awards in 2006: Best Single Issue, Best News Coverage, and Best How-To Article. Kudos to Editor Kimberly Weisul, Deputy Editor Susan Price, Art Director Edith Gutierrez, Photo Editor Kathleen Moore, and Copy Chief Marc Miller.

We're not slowing down. Our spring issue, hot off the press, builds on *BusinessWeek*'s groundbreaking reporting on innovation. The Cover Story, "Ideas That Bloom," is a guide to turning fresh ideas into competitive advantages, small-business style. Case in point: Numi Tea, a $7 million Oakland (Calif.) startup w novel "flowering" tea delivered 26% holiday sales. Also in this issue: the d of Doug Hall's "Jump Start" column the best thinking in innovation, and Worth," in which an entrepreneur f financial hurdles gets expert advice.

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Joyce T. Barnathan

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ReadersReport

READY TO GO PRIVATE? IT AIN'T ALL ROSES

THE "GLAMOUR" OF private equity ("Going Private," Cover Story, Feb. 27)? Not quite. EBITDA (earnings before interest, taxes, depreciation, and amortization) reigns, and we drive to Staples to buy binders for bank meetings rather than summon the company jet. "Less focus on quarterly results"? Uh, no. We're typically highly leveraged, we lose sleep over loan covenants, and the best way to make a year is still to make each quarter.

But "nimbleness"? And how! The right board, with the CEO and one or two other people, can indeed turn a piece of competitive intelligence into a competitive advantage within an hour. Now that's creating shareholder value.

–Michael K. Lorelli
President and CEO
Latex International
Shelton, Conn.

THOSE "PUBLIC COMPANY" costs, such as Sarbanes-Oxley and investor relations, that are eliminated in a leveraged buyout are frequently replaced with substantial "private company" costs, such as management fees and financing fees imposed by private equity sponsors as they attempt to increase their returns. These costs tend to come back quickly as sponsors work to achieve their "exit strategy" by returning the company to public markets through an initial public offering or sale to a publicly traded company.

–William K. Hall
University of Michigan
Ann Arbor, Mich.

KUDOS AND DAGGERS FOR AMHERST'S BOLD PLANS

SEVEN FULL PAGES were devoted to "Campus revolutionary" (Special Report, Feb. 27), profiling Amherst College President Anthony W. Marx and his ambitious plan for the "redistribution of educational opportunity." And not one word on the much bigger problem, in terms of numbers, facing middle-class kids—proven strivers and achievers—who cannot afford elite education.

Redoubling efforts to find more deserving poor and minority students is noble and commendable. But raising hundreds of millions of additional dollars to supplement faculty, build i structure, install remedial courses tutoring programs, and otherwise d down the institution is a foolish an wieldy waste of resources. If folks Marx devoted half as much energy t abysmal K-12 public school systen wouldn't need this discussion.

–James M. Dron
Pittsb

TO HIGHLIGHT AMHERST when t sands of community colleges have doing the same thing for decades wi mention, no fanfare, no cover st fewer resources, and, in most cases public funding, illustrates *BusinessW* myopic vision of the true state of h education and misses a much large more significant portion of how h capital is really developed in the U.S.

–Ryan S
Channaho

I ENTERED AMHERST in the fall of as a transfer student from a junio lege in riot-torn Newark, N.J. Whil two years at Amherst were very cha ing, I survived and prospered—gra ing with a solid B average. I recent

CORRECTIONS & CLARIFICATIONS

"Should directors be nervous?" (News: Analysis & Commentary, Mar. 6) incorrectly stated that Patrick McGurn, senior vice-president of Institutional Shareholder Services Inc., said ISS's proxy recommendations typically swing about 20% of investor votes. That estimate of ISS's influence came from other sources.

"Low tide for Amazon?" (Inside Wall Street, Mar. 13) should have said that Amazon.com's excess cash on the balance sheet, not free cash flow, is $4.24 a share.

"Sony's iPod assault is no threat to Apple" (Global Business, Mar. 13) incorrectly stated that the new Walkman NW-A3000 would be the first Sony Corp. digital music player with a hard disk drive to be sold in the U.S.

"Doll Wars" (Up Front, Mar. 13) should have noted that Mattel's claim that Barbie "continues to be the No. 1 girls' brand" is true if you include all Barbie-branded toys.

"And baby makes...a market" (Books, Feb. 27) incorrectly stated that 30% of U.S. men are infertile. According to the Cornell University Center for Male Reproductive Medicine, 10% of all U.S. men attempting to conceive suffer from infertility, and in about 30% of couples who are trying to conceive, the man is the problem.

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–John H. Nesbitt
Director, University Recruiting
& Employment Marketing
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St. Louis

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information was in *BusinessWeek*
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l that no timetable has been set for
paign, and certainly no dollar goal
en determined. You know how the
work; I'm afraid *BusinessWeek*
l the gun on that part of the story."
believe *BusinessWeek* ahead of offi-
nouncements any day of the week.

–Dick Hubert
Rye Brook, N.Y.

"The right board, with the CEO and one or two other people, can...turn a piece of competitive intelligence into...[an] advantage within an hour."

–Michael K. Lorelli
Shelton, Conn.

WHEN HOSPITALS COMPETE, COMMUNITIES WIN

AS A PARTNER in a failed specialty hospital, Heart Hospital of Milwaukee, I can offer a unique viewpoint on "Should doctors own hospitals?" (Science & Technology, Feb. 20). Since my investment has already been lost, I have nothing to gain. Our hospital was one of the heart hospitals built in partnership with MedCath Corp. Quality of cardiovascular care went up in every community in which MedCath built a heart hospital. The mortality rate for open-heart surgery in one community went from 10% to 4% in two years. The other open-heart programs in that city also got better because of the new player in town. Even if it works out in the long run that it costs the same as the current system, isn't it worth it to challenge these big, old systems that are operating the same today as they did 75 or 100 years ago?

–Dr. Bruce C. Wilson, President
Wilson Heart Care Associates
Mequon, Wis.

IT TAKES MORE THAN MARKETING TO SUCCEED IN BROADBAND

"THIS IS THE FACE of broadband TV" (Information Technology, Feb. 13) focused on the importance of understanding consumer behavior and marketing strategy. But PCCW Ltd.'s NOW Broadband succeeds because of its world-class technology platform. Programmers are attracted to our highly effective security protocol that stops piracy. NOW Broadband is a team effort that would have been impossible without the range of talents and disciplines we have in the group.

–Janice Lee
NOW Broadband
Hong Kong

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Net Movie Mogul

WHEN THE INTERNET bubble burst in 2000, it deflated a bunch of video-related startups. Staging a comeback just as giants such as Yahoo! Inc. were placing their own bets on video required a strong stomach and a stadium-sized ego. Mika Salmi had both. "I guess I just wasn't smart enough to realize people wouldn't use the Internet to watch entertainment," jokes the 40-year-old founder and CEO of Atom Entertainment Inc. Today, the company's two Web sites, shockwave.com and atomfilms.com, reach more than 28 million unique users a month with games, edgy cartoons, political lampoons, and other shorts. About 4 million of them log on specifically to watch the films—making atomfilms.com one of the Net's most successful independent movie sites.

Atom takes its personality from the gung ho Salmi, a six-foot-two-inch extreme sports fan and entertainment addict. The son of a former Finnish hockey pro, Salmi worked as a ski instructor and party DJ while getting a degree in finance at the University of Wisconsin in 1987. Intent on joining the music business, he sent 125 letters to New York record labels and was rejected by each before getting a foot in the door at TVT Records as a database manager. His big break came in 1998: On a late-night excursion to a local club, he discovered and signed the rock band Nine Inch Nails.

Moving to France, he got a master's degree at the European Institute of Business Administration and worked for record label EMI Group PLC. In Paris, he fell in love with a new species of short film featuring crude humor and bizarre story lines, which were being aired around the clock on an MTV-like cable startup. Salmi became a short-film aficionado, hitting every offbeat film festival he could find. Returning home to Seattle, he raised $8 million from friends and family and launched atomfilms.com, aiming to "atomize" content into smallish "entertainment snacks," he says.

The shorts could be jarring. Typical fare included a Spielberg spoof called *Saving Ryan's Privates* and an animated short featuring a frog in a blender. Atom would pay rock-bottom prices, typically $500 for a three-minute short, tl share the meager ad sales. As word of the site spread, Sa raised an additional $5 million in 1999, including $2 mi from the venture-capital fund of former Universal Studi CEO Frank Biondi. "Entertainment was being watched i minute increments, not 3 minutes," Biondi recalls, but " liked Mika, and he was getting some traffic."

Salmi's atomfilms.com survived the dot-carnage and now thrives on broadband

By 1999, Hollywood was crawling with com content plays, including Icebox, finan by writers from *The Simpsons*, and Pop.co launched by DreamWorks and director R Howard with financing from Paul Allen. S of these deep pockets wanted to buy Salm but he stood his ground.

Then came the tech bust. By 2001, mo the entertainment sites were out of busin killed off by slow Internet speeds and du advertising prospects. Atom ended up merging with Shockwave, where online g were the hot seller. But Salmi wouldn't g on shorts. He tirelessly shopped his cont for use on portable video players and cable TV, and he w first to sell TV-style advertising against such content. As broadband penetration rates climbed, Salmi found he h large audience eager to click on shorts like JibJab Media 2004 Presidential spoof *This Land*, which got passed ar as a link in some 80 million e-mails.

Today, with online ad sales booming, Atom has reven the "tens of millions," says Salmi—and serious competit from the likes of MTV, Comedy Central, and Yahoo. "I suppose I should be worried, but a rising tide will lift all boats," he says. If it doesn't play out that way and ships to sink, Salmi will be the first one out there with a parod

–Ronald G

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BY STEPHEN H. WILDSTROM

Finally, A Safer Explorer

Since the days of Windows 95, security experts have been beating up on Microsoft for the way it integrated the Internet Explorer browser with its operating system. A decade and countless security vulnerabilities later, Microsoft is finally conceding that the critics were right. This means big changes are coming in the version of Internet Explorer that's due this fall.

I have been using an early, and still buggy, test version of Internet Explorer 7, which will be released both as part of Vista (the next release of Windows) and in a separate version for Windows XP. It goes a long way toward separating the browser from the operating system. That makes browsing safer but less convenient since a number of things that used to happen automatically will now require your intervention.

The great weakness of IE has been the way Microsoft empowered the browser to download and run programs automatically. It didn't take long for the bad guys to figure out that this was an open door for attacks. Microsoft imposed restrictions on these "drive-by downloads" a couple of years ago as part of a major update to Windows XP, but IE 7 makes the rules much stricter. You have to give explicit permission even to run programs already stored on your computer, with the exception of a handful of well-known tools such as Macromedia Flash player or Real Networks' RealPlayer. As long as people don't mindlessly give permission to everything, this should make it tougher for hackers to exploit flaws in existing programs.

IN EFFECT, MICROSOFT IS TAKING AWAY the browser's special, trusting relationship with Windows. And with Vista the divorce comes with a restraining order. Even when you let IE run a program, it won't be able to create or change files or system settings unless you give it additional permission. This makes it far harder for a malicious Web site to hijack your home page or install a program that monitors your keystrokes.

These changes will cause many of the "scripts" that automate Web sites, as well custom programs written for corporations' internal Web sites, to fail. That's why Microsoft is urging Web masters to start experimenting with the software months before its release. Based on my experience, most sites will be fixed with time to spare, but many corporations will drag their feet in fixing internal software.

A more visible security change is designed to help prevent fraud. The new IE will warn people when a link they click on is likely to take them to a "phishing" site, the sort of place that steals passwords or other personal information. On known phishing the address bar at the top of the window turns red, and a warning appears, while on suspect sites th turns yellow. And in an effort to k Web sites from whisking you off t places you may not want to go, an new windows opened automatic must show their true identity in a address bar.

The downside: Splitting the Web browser from Windows means less convenience

There are also some nic badly overdue, usability improvements. You will b able to open multiple pag within a single window a save the group as a single bookmark; rival browsers as Firefox and Opera hav offered this "tabbed brow feature. And Microsoft ha finally provided a reliable to enlarge or shrink text, though in the version I've testing the bigger text isn always reformatted, so it sometimes sprawls off the right e of the window. I hope this feature will be fixed before rele

The convenience IE offered over other browsers, such a Netscape, helped fuel the explosive growth of the Web. Bu ease of use came at far too high a price. Partly because of t resistance of corporate customers that had built applicatio taking advantage of dangerous features, Microsoft was fa slow to fix them. But the software giant is finally biting the bullet, and late is a lot better than never. ■

E-mail: techandyou@businesswe

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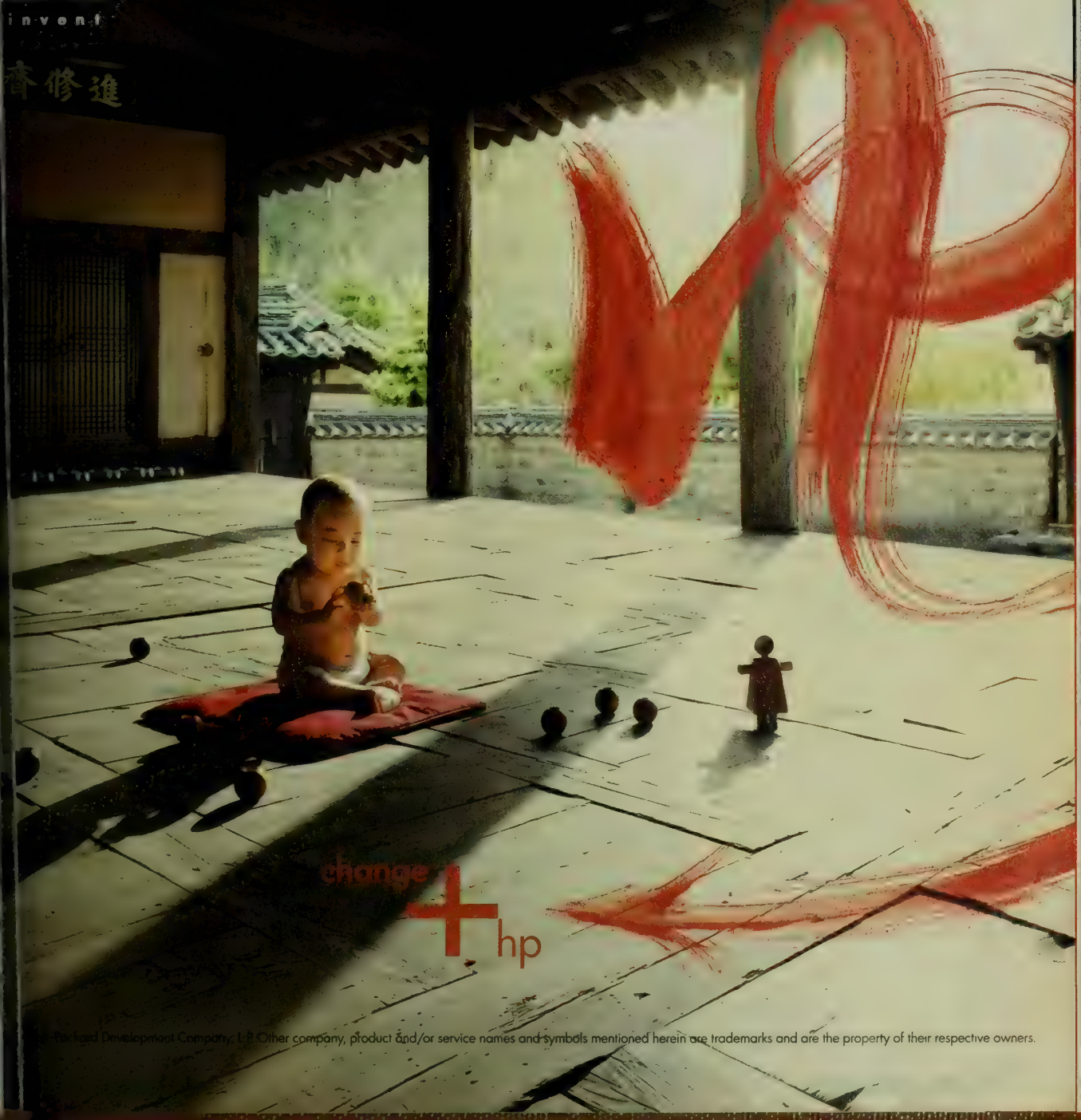

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MediaCentric BY RONALD GROVER

Media, Marketing, and Advertising in the 21st Century

Dibs on the Download Dough

He played the loser ex-husband in Cybill Shepherd's short-lived 1995 sitcom *Cybill*. Now, as president of the Screen Actors Guild, Alan Rosenberg has become a warrior in the digital age. Allied with Hollywoo other two major unions, the Writers Guild of America and the Directors Guild of America, Rosenberg intends to be the latest—and most

conspicuous—speed bump on Hollywood's digital highway. Elected last September on a pledge to "fight like hell to get actors their fair share," the 55-year-old actor says in his gravelly New Jersey accent that he hopes to increase the amounts that studios pay creative folks for downloads to iPods, computers, and cable systems. For Hollywood, which is banking on digital downloads to make up for slowing DVD sales and a sluggish box office, the message is clear: Your partners want their slice of the pie.

It's the day after the Oscars, and Rosenberg is sounding a cry that will be heard in the months ahead, not only from actors and writers but also songwriters, TV station owners, and others affected by this new revenue source. "They are corporations, and their motivation sometimes is to maximize profits and not put on good entertainment," says Rosenberg. He simply wants "a place at the table to show we are partners in making the content." Translation: It's time for Hollywood to cut some deals.

ROSENBERG AND THE OTHER Hollywood unions want an increase in the residuals their members get for the $1.99 downloads of shows such as ABC's *Lost* and *Desperate Housewives*. Together all unions now pull in a total of just 2¢ per download, says SAG, with actors getting 1.25¢. The problem is that ABC says the contract allows it to pay the unions based on the rates for DVDs, which SAG says are about a third of those for TV shows. Union leaders insist the network has chosen to pay the lowest residual rate and think their members should get more. The two sides are likely to fight it out in arbitration court, though it could spill over into a showdown in 2007 and 2008 when industry contracts expire.

The unions aren't the only obstacles for Hollywood. Local TV station affiliates of the big networks are steamed because day-old episodes of *Lost*, say, are being peddled over broadband, possibly draining away audiences for those shows. Meanwhile, studios that make programming for other company's network—think Sony, which makes the sitcom *King of Queens* for CBS—aren't rushing to sell dig downloads, at least not until that market begins to rival still-robust revenues for reruns and DVDs of shows.

Hollywood has so far dodged a few of these bullets. which is making video-on-demand versions of *CSI* and shows available through cable operator Comcast, has assuaged its affiliates by limiting the downloads to onl those markets where CBS owns the local TV stations. B there are some issues that be avoided. Take music righ You can't, for instance, download copies of the 198 flick *Ferris Bueller's Day Of* That's because the Beatles blocked it until they can ge price for the song *Twist an Shout*, which is on the soundtrack. Other songs a similarly restricted by righ owners. DVD rental service Netflix, which has a 50,00 flick catalog, offers films and shows tha already cleared those music rights. By contrast, the studio-owned Movielink download site has only about 1,200 ti says Jim Ramo, Movielink CEO. A lar catalog, Ramo says, "is the tipping p

All it will take is money, and Hollyw has plenty of that. For years, the entertainment industry has grown by new technologies to distribute old far profit in the digital era, executives ma to think about sharing some of the ne found wealth, before Rosenberg and partners try to do the divvying for the

Actors get just over a cent from ABC for every $1.99 download

ROSENBERG Headed for a Hollywood showdown?

BusinessWeek online Jon Fine returns next week. For his blog, go to www.businessweek.com/innovate/FineOr

JAMES C. COOPER

The Double Whammy That Could Ignite Inflation

en slowing productivity growth and quickening labor costs collide...

U.S. ECONOMY Stellar productivity growth in the U.S. has become h a common feature of the economic landscape, it's easy to take it granted. That would be a mistake, especially now when efficiency ns are slowing down. This year smaller productivity increases will e businesses less of an offset to rising labor and other costs than in t years. That will put pressure on companies to lift to keep profits from getting squeezed. At stake: the path of inflation and interest rate decisions by the al Reserve.

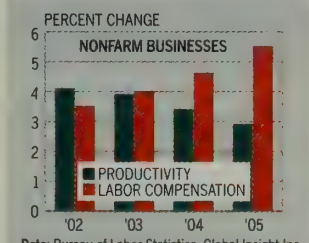
t year, productivity—measured as output per hour d at nonfarm businesses—grew 2.9% from 2004, ling to the Labor Dept.'s Mar. 7 report. That was a showing, given that the pace was higher than the erm trend, generally accepted to be about 2¼%. It so impressive given the unusual weakness at nd. Based on Labor's revised data, fourth-quarter ctivity fell at a 0.5% annual rate from the third r, but that drop reflected the same temporary tions from autos and weather that caused the n falloff in the economy's overall growth rate. king through the quarterly ups and downs, ctivity has slowed progressively for three utive years at a time when wages and benefits of rs have accelerated. Last year, compensation grew he fastest clip in five years (chart). The likely uation of these two trends in 2006 will become for the inflation outlook, because it means unit osts will be speeding up.

labor costs are compensation costs that are not y productivity gains, and they correlate tightly flation. Last year unit costs grew 2.6% from 2004, e fastest pace in five years. Up to now, with tivity growing strongly, tight labor markets and l pressure on wages have not presented much of a n. But in the coming year, all that could change.

EAR, THE TRENDS in productivity and nsation will most likely continue to diverge. tivity will follow its typical slowdown pattern as a ss-cycle upturn gets older. Right after a recession, per hour tends to surge as companies stretch their payrolls to meet demand. Later, as is happening ose gains fade, as more workers are needed to roduction. At the same time, with job growth and labor markets already tightened to the point wages are starting to grow faster, overall labor ill continue to grow at an elevated pace.

ast time accelerating unit labor costs raised inflation alarms was in the late 1990s. Back then, the growth of unit costs surged from 0.7% in 1996 to 4.2% in 2000. However, that was when the world was awash in production capacity following the Asian crisis in 1997 and the financial turmoil after the Russian debt default in 1998. Growth outside the U.S. was generally soft, and the dollar had strengthened greatly. All this prevented U.S. companies from pushing through price increases to offset the additional cost of making one of their products. Instead, businesses suffered one of the sharpest contractions in profit margins on record.

PRODUCTIVITY SLOWS AS PAY PICKS UP



Data: Bureau of Labor Statistics, Global Insight Inc.

Now, global conditions are much different—and much more conducive to greater pricing power. Chinese demand is soaking up capacity throughout Asia, even as the Japanese economy emerges from its slump. Global labor markets are tighter as world growth continues to pick up. And the dollar is down sharply, to levels below those of the late 1990s.

As a result, it's not surprising that commodity prices are strong, and many companies have had more success in lifting product prices to cover their cost increases, especially energy costs. Nor should it be startling that companies are maintaining high levels of profit margins, despite the faster pace of unit labor costs.

THE DEGREE TO WHICH PRODUCTIVITY growth slows this year will depend a great deal on the number of new efficiencies that businesses can exploit from their existing technologies. To understand why that's true, consider that the technology boom since 1995 has driven productivity growth in two different ways.

From 1995 to 2000, the primary driver was massive business investment in new hardware and software that gave workers better technology to help them perform their jobs. During that time, price-adjusted business

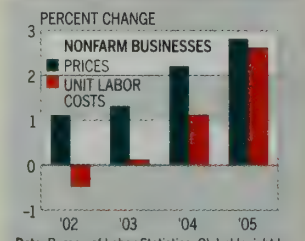
outlays for high-tech gear grew at about a 20% annual rate. But since the peak of the tech boom in 2000, productivity gains from new investment have eased, with tech outlays growing less than 5% per year. Only recently has the pace of tech investment re-accelerated, but growth still lags well behind that of the late 1990s.

However, during the past five years, a new productivity driver took over. Economists call it, in the simplest terms, technological progress. In not-so-simple terms, they call it multifactor productivity. It means that companies learned new ways to use their equipment more efficiently to reorganize and streamline their production and distribution processes. So despite the slowdown in the pace at which businesses were investing in new tech equipment, companies continued to make big gains in efficiency that helped to boost output and cut costs.

The good news is that the speedup in investment in information technology since 2004 is laying the groundwork for more gains in technological progress later in the decade. But in the next year or two, these types of productivity gains may well slow, especially since their contributions appear to have been far greater than their recent trend. Unfortunately, hard data on this productivity driver are lacking. The Labor Dept.'s official numbers run only through 2002, but that year's gain was more than twice the average in the previous 10 years.

THE PATTERN OF PROFITS and profit margins this year will say a lot about how businesses are coping with slower productivity and faster unit labor costs. In the second half of last year, unit costs grew a shade faste than originally estimated, mainly because the rise in wages and benefits turned out to be greater. Newly revised data show that wages and salaries in the thi quarter grew at a 6.5% annual rate from the previou quarter, instead of 5%, and 4.7% in the fourth quart instead of 4.4%.

PRICES ARE OUTPACING UNIT LABOR COSTS



Data: Bureau of Labor Statistics, Global Insight Inc.

Even though productivity slowed year, businesses mo than covered the ad compensation costs higher prices. On average, the labor c making a given iten up to 2.6% last year, the price of that iten increased slightly fa at 2.8%, up from 2.1 2004 (chart). That r profit margins held up well last year.

This year, businesses will continue to test the ma to see how much additional pricing power they can muster. Given the combination of strong demand a rising utilization rates, both in the U.S. and overseas likely that companies will find more pricing leverag so, that could be a mixed blessing for investors. Prof would continue to grow at a healthy pace, but intere rates would be sure to climb further as the Fed beco increasingly concerned about prospects for inflation

EXPORTS

Can't Ship 'Em Out Fast Enough

RESILIENT GLOBAL economic growth has the manufacturing sector on an upswing in the U.S. and in most parts of the world. As a result, idle factory capacity is getting gobbled up. That's good news for the U.S. industrial sector as higher global investment spending should spur further gains in capital goods exports.

According to calculations by *BusinessWeek*, global capacity utilization in manufacturing is back up to levels last seen in late 2000. The index of global capacity utilization includes the U.S., Germany, Japan, and 31 other countries—but not China or India—that combine to account for nearly 79% of global economic output.

FACTORIES HUMMING AROUND THE GLOBE

Data: JPMorgan Chase & Co., Global Insight Inc., World Bank, *BW*

Strong demand has pushed up capacity utilization rates such that nearly three-quarters of the countries are above their long-run average. And early first-quarter numbers from the U.S. and around Europe show the upward trend remains intact.

As spare capacity steadily evaporates and expectations rise that global economic growth in 2006 will outpace last year, companies are likely to ramp up investment spending. In Canada, for example, a government survey shows outlays for plants and equipment are expected to rise by 8.2% this year, vs. 7.6% in 2005.

A resurgence in global capital spending is particularly good news for American manufacture Non-auto capital goods account 40% of all U.S. exports. There a indications that factories are alr beginning to see an acceleration demand. Exports of capital goo rose 13% from a year ago in the quarter of 2005, and the Institu Supply Management's February factory activity report showed continued strength in export or

Increases in investment spen by companies at home and abro should also push U.S. manufact to pump up their capital outlays unused capacity declines. The U capacity utilization rate in the fa sector in early 2006 already exc its long-run average of 79.8%. P rising demand should allow manufacturers to maintain the pricing power they were able to obtain in the wake of last year's soaring energy prices. ■

–By James Mehring in Ne

Ve're incorporating the skin care you like vith the high-SPF sunscreen you need.

r if you prefer, vice versa.

Cleansers and moisturizers help maintain healthy, good-looking skin. V an ingredient's been missing. New technology from Dow Dispersion Sences lets manufacturers add high-SPF sunscreen to their products to help protect against skin cancer. With no heavy, greasy feeling on your skin. To make something more beautiful, you just need the right chemistry.

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The Business Week

News you need to know

EDITED BY HARRY MAURER

March Merger Madness It's shaping up to be a year for the M&A history books. The big daddy this week is **AT&T's** $67 billion call to **BellSouth,** announced on Mar. 6. But lots of other deals crossed the wires. Among them: **Blackstone Group** grabbed the **CarrAmerica** REIT for $5.6 billion; **Providence Equity** and **Goldman Sachs** offered $3.4 billion for **Education Management;** and **NBC Universal** nabbed the **iVillage** Web site ($600 million).

So far, 2006 has witnessed 21 U.S. deals worth a total of $184.4 billion, according to Thomson Financial. That portends a banner year like 2005, the best for global M&A since 2000. The big reason? Corporate strategists and private equity honchos are putting their overflowing coffers to work. In the U.S., buyout firms are sitting on $150 billion in cash, which could fund as much as $600 billion in deals, says JPMorgan Chase's global buyout advisory unit.

See "Lord of the Rings," page 30, and "Is Verizon Heading South?" and "NBC Universal Takes an iVillage," www.businessweek.com/go/tbw

Garage Sale **GM** is unloading stakes and slashing benefits to raise cash and curb losses. The carmaker further unwound its strategy of aligning with foreign companies by cutting its stake in **Suzuki** from 20.5% to 3.7%, netting $575 million to $750 million. On Mar. 7 it also froze its defined pension plan for 42,000 salaried workers, which will save it $1.6 billion this year. While GM is trying to avoid bankruptcy, auto parts supplier **Dana** couldn't manage it. The Toledo company filed for Chapter 11 on Mar. 3, joining **Delphi, Tower,** and **Collins & Aikman.**

See "GM: Cashing In on Suzuki," www.businessweek.com/go/tbw

Fastow Sings In the key moment of the **Enron** tria far, **ex-CFO Andrew Fastow** said for the first time on that former **CEO Jeffrey Skilling,** and to a lesser exte **Chairman Kenneth Lay,** knew about and encouraged th books entities that allowed Enron to generate fake p

See "Something a Jury Can See," p

Bond Market Blues U.S. bond mavens conclude they didn't like the look of things, so they drove the 1 Treasury note yield up from 4.55% to 4.75% betwee 28 and Mar. 6. Comments by **St. Louis Fed Bank Pre William Poole,** who suggested speedy expansion woul monetary policy makers to "step a little harder c brake," spooked traders already anxious about in and the prospect that the Fed may not be near the en long cycle of tightening after all. The **European Bank's** Mar. 2 quarter-point hike, to 2.5%, didn't help

See "Tough Rate Calls at the Fed, ECB, and www.businessweek.com/g

Wendy's Makes Peace For better or worse, it's b basics at **Wendy's.** The No. 2 burger outfit by sales kn under to investor **Nelson Peltz** and said on Mar. 2 that sell off its 2,790-outlet **Tim Hortons** donut-and-coffee The Dublin (Ohio) company also gave Peltz's **Tria** three seats on its board and may jettison its limp **Baja** eateries. Shareholders may not find Wendy's as app without fast-growing Tim: Same-store Wendy's sales ded every quarter in 2005. As for Peltz, he's alrea manding five board seats at his new target: **H.J. Heinz**

Intel's Mixed Bag Warning? What warning? Sur cautioned Wall Street on Mar. 3 that first-quarter rev would miss targets because of weaker-than-expect mand. But that didn't stop the world's largest chip from spinning rosy scenarios four days later at its se nual developers' forum. **CEO Paul Otellini** said archriv **vanced Micro Devices** should be looking over its shoul Intel shows off the best-performing server chips in and builds an arsenal of next-generation fabs. Tha offer cold comfort to investors, who worry the two fire up a price war that will short-circuit margins.

See "AMD Chips Away at Intel," www.businessweek.com/g

They're Angry at HP. Did **Carly Fiorina** walk awa too much cash? Two union pension funds sued **H Packard** on Mar. 7, claiming that a $40 million-plus ance package for the fired CEO broke company rule lowing **Michael Capellas'** exit in 2002 with an estimat million after just seven months on the job, HP agree shareholders O.K. any package more than 2.99 tim exec's salary and bonus. The unions say Fiorina's de passed that limit. HP says it ain't so.

Bruised BlackBerry Now maybe **Research in Moti** focus on its real worry: staying ahead of the rivals at its heels. On Mar. 3, RIM, maker of the popular **Bla**

ireless e-mail and phone gizmos, agreed to shell out .5 million to settle its seemingly endless legal bout patent holding company **NTP.** RIM stock clicked up on Mar. 6, but analysts cautioned that the uncertainty ed customers to examine the wares of **Microsoft, Palm, Nokia,** all of them working hard to cut RIM's 70%-plus ket share.

See "BlackBerry Won't Get Squashed," www.businessweek.com/go/tbw

ional Exuberance? He's known for "Fedspeak," h doesn't exactly read like an Elmore Leonard novel. former Fed boss **Alan Greenspan** still reaped an $8.5 on-plus book deal from **Penguin,** according to the *New Post,* which broke the story on Mar. 7. Factoring in in-n, that's probably the fifth-biggest advance ever, fol-g payouts to **President Bill Clinton, Pope John Paul II, ex-O Jack Welch,** and **Senator Hillary Clinton.** Will Penguin money? Dismal scientists, place your bets.

y's New Cook During 25 years in the packaged biz, **Daryl Brewster** has helped spice up his share of led brands: **Campbell Soup** in the late 1970s and, more tly, the **Planters** division of **Kraft.** Now he'll try to make **Kreme** fat again. He was named CEO on Mar. 7. y is reeling from an accounting scandal and ill-con-d expansion, but Brewster sees sweeter days ahead. t appealed to me was the strength of the brand," he "And when I look at per-capita sales, I see a lot of for growth." Wall Street certainly got a sugar buzz: y soared 21%, to $7.71, on the day of the appointment.

See "Can Krispy Kreme Rise Again?" www.businessweek.com/go/tbw

Succession of the Week

Sage of Omaha sometimes sounds more like the le of Delphi, which had a way of uttering in-able predictions that left a lot of room for interpre-n. In his 2005 **Berkshire Hathaway** shareholder re-released on Mar. 4, **Warren Buffett** says the board icked a successor. But he doesn't reveal who his s, and muddies matters by saying the choice could ge. Of course, even such eness sparks fierce specula-Most often named: **Joseph on of General Re; Ajit Jain** of al Indemnity; **Tony Nicely** of); **Richard Santulli** of **NetJets; avid Sokol** of **MidAmerican En-Holdings.** Ambiguity aside, holders should be pleased. te disasters like Hurricane a, net earnings were up to $8.5 billion. And Buffett minced no words in sting hedge fund managers and other pros for ing high fees and essentially fleecing investors.

WARREN BUFFETT

See "Buffett's Imposing Legacy," www.businessweek.com/go/tbw

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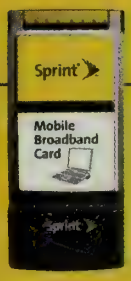

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TELECOM WARS

LORD OF THE RINGS

AT&T CEO Ed Whitacre's BellSouth deal will create a $165 billion colossus. But unlike the old Ma Bell, it faces a pack of hungry rivals in a morphing market. BY ROGER O. CROCKETT

EDWARD E. WHITACRE JR. has a thing for airplane hangars. The chief executive of AT&T Inc. has cut numerous acquisitions in these cavernous confines, including his $61 billion purchase of Ameritech Corp. So when Whitacre and BellSouth Corp. CEO F. Duane Ackerman were getting close to finalizing terms for AT&T's proposed $67 billion acquisition of BellSouth, the two boarded their corporate jets and flew to a nondescript hangar in Memphis. No deal lieutenants were there. No lawyers or bankers. Just Ed and Duane. Together, they worked the deal out on notepads and shook hands. "We hammered out most of the details right there," Whitacre said in an interview. "We had a feeling that now was the time to do this."

The long-anticipated acquisition looks like a coup for the telecom veteran. Since the Telecommunications Act of 1996 cracked the door to competition, Whitacre has aggressively refashioned his regional telephone monopoly, formerly SBC Communications Inc., into a vast global competitor. He renamed the company AT&T after acquiring the long-distance icon last fall. The BellSouth deal still needs the blessing of shareholders and regulators. But if it's approved, as expected, Whitacre will have created the largest telecom provider in the world, with $120 billion in revenues and a market cap of $165 billion.

UNDER SIEGE

HE'S BETTING THAT size and scale will allow him to seize the crown in his industry. His primary motivation for the latest deal was to get full control of Cingular Wireless, the country's largest wireless provider that's now a joint venture between AT&T and BellSouth. In addition, he figures that with the largest phone company in the land, he'll benefit from economies o providing the cash to push into nev kets and develop innovative pr "[The deal] will create a strong na and global competitor, better positio innovate and deliver new services t businesses and consumers," he say

But the industry Whitacre worked in his entire life is morph light speed, creating challenges a falls for the would-be king. In n after market, his company is siege by rivals. The raging comp is transforming the telecom indu the point that its very name is bec obsolete. Cable companies like Co and Net players like Google are p into the telephone business, AT&T and its peers are movin everything from cable televisi computer security. "Sure, AT&T v big," says Ed Lewis, general part consultant RelevantC Business C

IN THIS SECTION:
Verizon's TV inroads in a Texas town
38 A smoking gun in the Enron trial?
40 Taking background checks to a new level
43 Futures trader John Henry's serious slump

Whitacre's Empire

By acquiring BellSouth, AT&T becomes the largest telecom provider by a wide margin over Verizon. Still, AT&T's services face intense competition:

BASIC VOICE

» With BellSouth, AT&T will have a league-leading 71 million lines in 22 states.

Prospects: Rivals are stealing customers. Last year AT&T lost 2.9 million lines, or 5.6% of its total lines, to competition, and BellSouth lost 1.2 million, or 6.2% of its total.

BUSINESS

» AT&T is the dominant supplier of service to big U.S. businesses, with $27 billion in sales.

Prospects: AT&T will have a tough time unseating Verizon in the Northeast. Acquiring BellSouth could lock out rivals seeking to poach business customers in the fast-growing South.

WIRELESS

» The deal with BellSouth gives AT&T 100% of Cingular Wireless, the No. 1 wireless carrier.

Prospects: Verizon Wireless and Sprint Nextel are both growing faster than Cingular. And with Verizon retaining more of its subscribers, many expect it to pass Cingular by 2007.

BROADBAND

» With BellSouth, AT&T pushes past No. 1 Comcast, which has over 8.5 million broadband subscribers.

Prospects: Cable providers won't sit idly by. They're acquiring new customers all across the country by raising broadband speeds and lowering prices.

VIDEO

» BellSouth brings fiber-rich netwo that could boost AT& video reach to many more homes.

Prospects: AT&T's video play is a defens move as the cable gu roll out phone service AT&T's technology is unproven, and it will t the company years t catch up with cable.

"But they're in a dogfight."

Whitacre's fundamental challenges won't go away with one more deal. His company has dim prospects for growth, with revenue increases expected to average less than 1% for the next five years. Worse, the business that's being picked apart by rivals like Comcast is the traditional phone business, with the rich margins that come from a near-monopoly. Meanwhile, the areas AT&T is moving into, including wireless and cable TV, are much more competitive. The situation is only going to get more difficult. Analyst Anthony Noto of Goldman, Sachs & Co. believes that companies like AT&T could lose 40% of their land-line residential customers over the next 10 years.

The BellSouth deal risks becoming a distraction from the task at hand. Over the coming months, Whitacre will have to battle consumer groups and rivals who want to stop the acquisitions or impose heavy conditions on its approval. If the deal closes, he'll then have to take on gantic integration task, one that inc melding the acquisitions of AT&T less and AT&T. The latter deal closed five months ago. "The difficulty g mightily as you layer transaction on t transaction," says David Barden, an at Bank of America.

There's little margin for error. Wh paid a hefty premium for BellSouth more than its market cap the day b the deal was announced. AT&T says

TELECOM WARS

Why Fierce Price-Cutting Could Be Gone in a Flash

Competition in communications seems cutthroat. Companies are invading each other's turf, and prices are falling. You can make a video-phone call to Australia via the Internet, chat for three hours, and never pay a penny. Citing all this hubbub, AT&T Inc. argues that there's no threat of re-monopolization even as it bids to reunite five of the eight companies that emerged from the 1984 breakup of the Bell System.

Look out, though. The competition we're seeing is just a phase, and an unstable one at that. The key thing about communications networks is that they're very costly to build, but once they're built, it's cheap to add customers to them. This industry structure has special economic properties. At times it produces price wars. At other times it leads to merger waves, resulting in a small number of competitors with the ability to raise prices and garner big profits. This time, the transition from ruinous competition to over-consolidation could be breathtakingly rapid.

Put yourself in the capacious cowboy boots of Edward E. "Big Ed" Whitacre Jr., the CEO of AT&T. He's investing heavily in fiber and wireless networks. He knows the only way he can make a return on his investment is if many, many customers use his network. For him, the worst possible outcome is that lots of other bigfoot CEOs with competing networks, like the cable execs, grab so m traffic that he can't recoup his multibillio dollar investment.

In this delicate situation, Whitacre and rivals have used two main strategies over years. One has been to cut prices to fill up networks. Remember, additional custome are cheap to serve, so there's room to cut. the battle for market share, companies lik AT&T will remain tempted to keep cutting prices as long as the customers they attra make at least a little contribution to cover the hefty up-front cost of building the net But here's the trouble: Unbridled competi eventually pushes prices to the point whe total revenue no longer covers total costs. Companies that were once gung ho lose interest in making further investments. Th may even have trouble paying off the debt from past rounds of expenditure.

The alternative strategy, which Whitac and others have also pursued, is consolidation. As long as regulators perm the strong buy the weak and extinguish th excess capacity. As competition eases, th survivors can raise prices and restore the

JACK PLUNKETT/BLOOMBERG NEWS

s to reap $2 billion in savings per year. But use of the premium, South shareholders will virtually all of the ben- from those savings. Jef- Halpern, an analyst Bernstein Research, ngraded AT&T after the isition was announced, ng its stock "dead mon- He cited the company's lingness to overpay for a riorating asset" and "the challenges risks associated with executing yet her large deal while juggling numer- other operational priorities."

hitacre's chief competition is coming cable companies. By bundling to- er TV, broadband, and newfangled net phone service, they're swiping mers from AT&T across the country. 've also struck a partnership with it Nextel Corp., allowing them to of- vireless services. These rivals say acre now has to defend the tradi- l phone businesses in two regions, wn and BellSouth's. "They're bigger, heir problem is that they're more ex- l to cable and wireless competition," Sprint CEO Gary D. Foresee.

hitacre wants to counter the threat by ng his own wireless company more rful. After all, wireless is the fastest- ng segment of telecom. Although Cingular is the largest provider in the U.S., with $34 billion in revenues, it lags behind Verizon Wireless in profitability and customer retention.

To compete in TV, AT&T may end up spending $7 billion on upgrades

Whitacre figures full control of Cingular will allow him to move more decisively. In recent months, BellSouth and AT&T have clashed over a variety of issues, including whether AT&T would be able to sell a wireless phone under its own brand using the Cingular network. While AT&T hoped to more easily bundle wireless with phone and broadband services, BellSouth resisted. "They sometimes really struggled to get agreement," says an industry consultant close to the companies. Now, Cingular will take the AT&T name.

RUDE AWAKENING

ANOTHER OF WHITACRE'S big bets is on television services. He's laying fiber lines that can carry TV signals throughout his territory, an initiative that he'll carry into BellSouth's region. The idea is to go after the same cable companies that are offering telephone service, so AT&T can match their bundle of services. But the initiative is massively expensive. AT&T is spending $5 billion to upgrade its own networks, and analysts expect it'll pay at least $2 billion on BellSouth's network.

Tough times? Maybe. But Whitacre has never been one to shy away from a tussle. In 2004, when he was trying to buy AT&T Wireless to wrap it into Cingular, a crisis hit. Whitacre thought he had the deal in hand when he got a late-night phone call from his lawyers. They told him Britain's Vodafone Group PLC had outbid him by 50¢ a share. Whitacre didn't blink. He woke up every member of SBC's board of directors for a teleconference at 1:30 a.m. He then pushed for approval to up SBC's bid by $1 a share, or about $3 billion. The board quickly agreed.

This time, Whitacre is facing what's likely to be his last major challenge. He was expected to step down as CEO this fall, after reaching his company's retirement age of 65. But now he will stick around until March, 2008, to run the combined companies for at least a year. "I never had designs on being the biggest," says Whitacre. "I just want to be the best company." ■

–With Brian Grow in Atlanta and Spencer Ante in New York

More On The Merger

FaceTime Maria Bartiromo's interview with AT&T CEO Ed Whitacre (page 114).

Outside Shot Leo Hindery is skeptical about the benefits of the deal (page 116).

ability. (Good for shareholders; bad for mers.) Profits may even get so rich that ntrants are drawn in, in which case price- g will once again predominate. Alterna- the barriers to entry may be so high that arket settles into a kind of cozy club.

Between these two scenarios, where are we right now? Maybe halfway. There's obviously still lots of competition, but there are also lots of mergers. More and more, the strife is between a handful of giants. It's easy to imagine a merger next between, say, Sprint Nextel Corp. and one of the big cable guys like Comcast Corp. or Time Warner Inc., with whom it's co-marketing. As for the Bells, Nicholas Economides, an economist at New York University's Stern School of Business, worries that if the AT&T-BellSouth deal is approved, "we are one more merger away from full monopoly."

For consumers, the best hope is a steady stream of technological breakthroughs that prevents incumbents from ever getting a lock on the market. Microwave technology allowed MCI to crack the Bell System. Then there was fiber, and now the Internet. But at present, the forces of consolidation are strong.

–Peter Coy

HARRY CAMPBELL

Fragile Competition

Communications companies may be shifting strategies from battling to consolidating

STRATEGY 1

Price War Companies need lots of traffic to cover the costs of their expensive networks. So they cut prices. But that forces other companies to reciprocate. Eventually profits vanish.

STRATEGY 2

Merger Wave Companies merge, with the strong buying the weak. As competition diminishes, profits rise. This strategy is more desirable to the companies, but may be banned by regulators.

BLOCK PAR
Clemons (
entertains
neighborh
gamers

TELECOM WARS

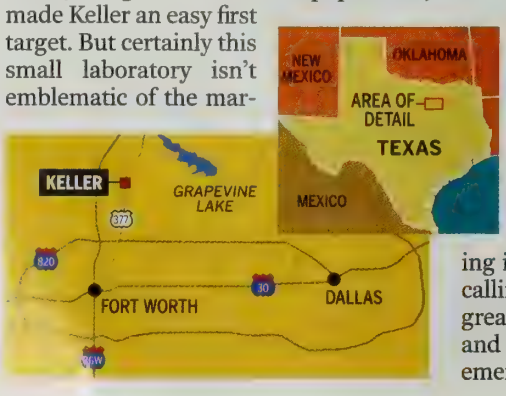
BATTLING FOR THE EYES OF TEXAS

Verizon's TV service is winning fans in a Fort Worth suburb. Will it sell nationwide?

BY MARK MORRISON

IF YOU'RE WONDERING WHY your cable and satellite stocks are slumping or why AT&T Chief Executive Edward E. Whitacre Jr. is paying a fat premium for BellSouth Corp., take a spin through Keller, Tex. Little more than scruffy prairie two decades ago, this booming suburb of 34,000 near Fort Worth and Dallas is the staging ground for what promises to be the next great media battle among providers of TV, broadband, and phone services. Up and down Keller's Coyote Court, Mesa Trail, and Indian Blanket Drive, phone giant Verizon Communications Inc. is signing up slews of customers—for a new TV service.

Keller is Big Telecom's first full-fledged assault on a local video market. And while Verizon's early gains look good, nobody is willing to declare just yet that its multibillion-dollar gambit to go up against the long-established cable and satellite guys is a winner. Quick approvals from city officials, along with an affluent population, made Keller an easy first target. But certainly this small laboratory isn't emblematic of the markets ahead, as Verizon prepares to make its service available to 15 million homes by the end of 2009.



What's going on in Keller is attracting attention, thoug Feb. 10, Federal Communications mission Chairman Kevin J. Martin his fellow commissioners traveled h see the Verizon rollout firsthand a hold a hearing on video compe Keller has not disappointed on that Just three months after a Septe launch, Verizon had grabbed more 20% of the local paid-TV business.

VIDEO PIONEERS

WITH SUBSEQUENT DEBUTS in York, California, Virginia, Florida elsewhere in Texas, Verizon is nov on the way with grander plans to about 50% of its customer over the next three years. "" been setting targets and m them," says Marilyn O'Co Verizon senior vice-preside video services.

Verizon and other telecon counting on Internet and T enues to offset their steadily ing income from local and long-dis calling. The new competition is p great strain on the balance sheets of and telecom players, while cons emerge as the big winners. Over th

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five years they will likely see dramatic improvements in TV and Internet services and relief from ever-skyrocketing prices. Verizon is charging about $100 a month for a package of TV, Internet, and phone services in Keller, competitive with cable and satellite offerings in town.

Town residents are taking their role as video pioneers quite seriously. Like thousands of neighbors, Vernon Drewa, a retired manager for the Federal Aviation Administration, canceled his old provider, satellite service DirecTV, and signed up with Verizon. He likes the sharp quality on his five TVs—and the lack of interruptions that plagued his satellite signal on stormy days. As a history buff who swaps research around the world, he is thrilled to download a 2,500-page document in less than 10 minutes instead of the hour it used to take with his old Verizon hookup. There's no turning back for Drewa. He recently ripped down the 12-foot satellite dish in his yard. "I took it to the lake house," he says. "I'm hoping it will work as a fish hatchery."

On a nearby street, local real estate agent Marc Clemons has become one of the most popular guys on the block. The neighborhood kids flock to Clemons' two-story house to play video games at superfast speeds on his fiber-optic-wired flat-screen TV. When he's not playing host, he and his wife watch their favorite shows and marvel at the rich picture. "All my neighbors have to do is see the clarity, and they've got to have it," says Clemons.

For all of Verizon's gains, though, it's too early to write off cable and satellite providers. Keller, 14 miles northeast of Fort Worth, won't be an easy model to replicate elsewhere in the country. Verizon chose an affluent venue with an existing cable provider that offered no phone service. Cattle still graze on a few remaining undeveloped tracts, but most of the farmland has turned into street after street of homes that average about $250,000. Attracted by a well-regarded school district and an easy commute to Dallas and Fort Worth, upwardly mobile families (93% of residents are under 60, with average household income near $100,000) are flocking to town.

It's a great place to do business, too. Highway 377, the main thoroughfare through Keller and adjacent bedroom communities, is a magnet for the usual cast of fast-food chains, banks, and retailers. When Verizon, the main phone company in Keller by virtue of the 2000 Bell Atlantic Co.-GTE Corp. merger, approached City Hall two years ago for permission to upgrade with fiber optics and later to get a TV franchise, there was little resistance. "Our initial response was, 'why not?'" recalls City Manager Lyle H. Dresher. Fiber optics could be a drawing card to attract tax-paying businesses to Keller. And if overall revenues for video services increase, the city gains from its 5% cut of whatever Verizon makes there.

Verizon nabbed 20% of the town's paid-TV business in three months

PERFECT TARGET

IT'S SURELY NO coincidence that Verizon picked a town where it could cinch a franchise agreement without long delays. Because most of Keller's infrastructure is new, fiber optics could easily be installed through modern underground conduits without tearing up local streets. What's more, Verizon was able to pit its sales effort against a weaker, local cable franchise, Charter Communications, rather than one of the cable industry's bigger guns like Comcast or Time Warner Cable. Charter contends competition is nothing new. In fact, the cable company appears to have preemptively lowered its fees for new service by as much as 50% before Verizon arrived. Charter denies that its promotion was related to Verizon's entry.

Still, persuading sumers to let a phon fit provide television ice is a huge chall Verizon decided tha usual mass-marketir fort would cost too and be ineffective in s tiny market. So Mark Director Brian An devised a guerrilla paign, staging event included offering kic chance to dabble with the fast Net s and crisp video (table). "We asked selves who would most appreciate c loading at up to 5 or 15 [megabyte second]," says Angiolet.

The huge capacity of fiber means Verizon can promise to adding bells and whistles. It alread livers about 400 channels, incl more than 20 high-def outlets. An company claims it will be able t more local programming and fo language packages.

The cable guys tend they can cor increasing speeds capacity without p for fiber-optic line ning to the home, ly because they spent $100 billion 1996 to upgrade lines. They already a big lead in broac Internet and are t sizable market from the telecon selling customers dles that include phone services.

Just the same, zon is picking up mentum in where it has intro fiber-optic TV in 1 er towns. The tele got a huge brea summer when passed a law that establishes sta state-issued franchises. This makes sible to enter new markets without tiating franchises with each locale. zon will need other states to follow it is to keep on its game plan.

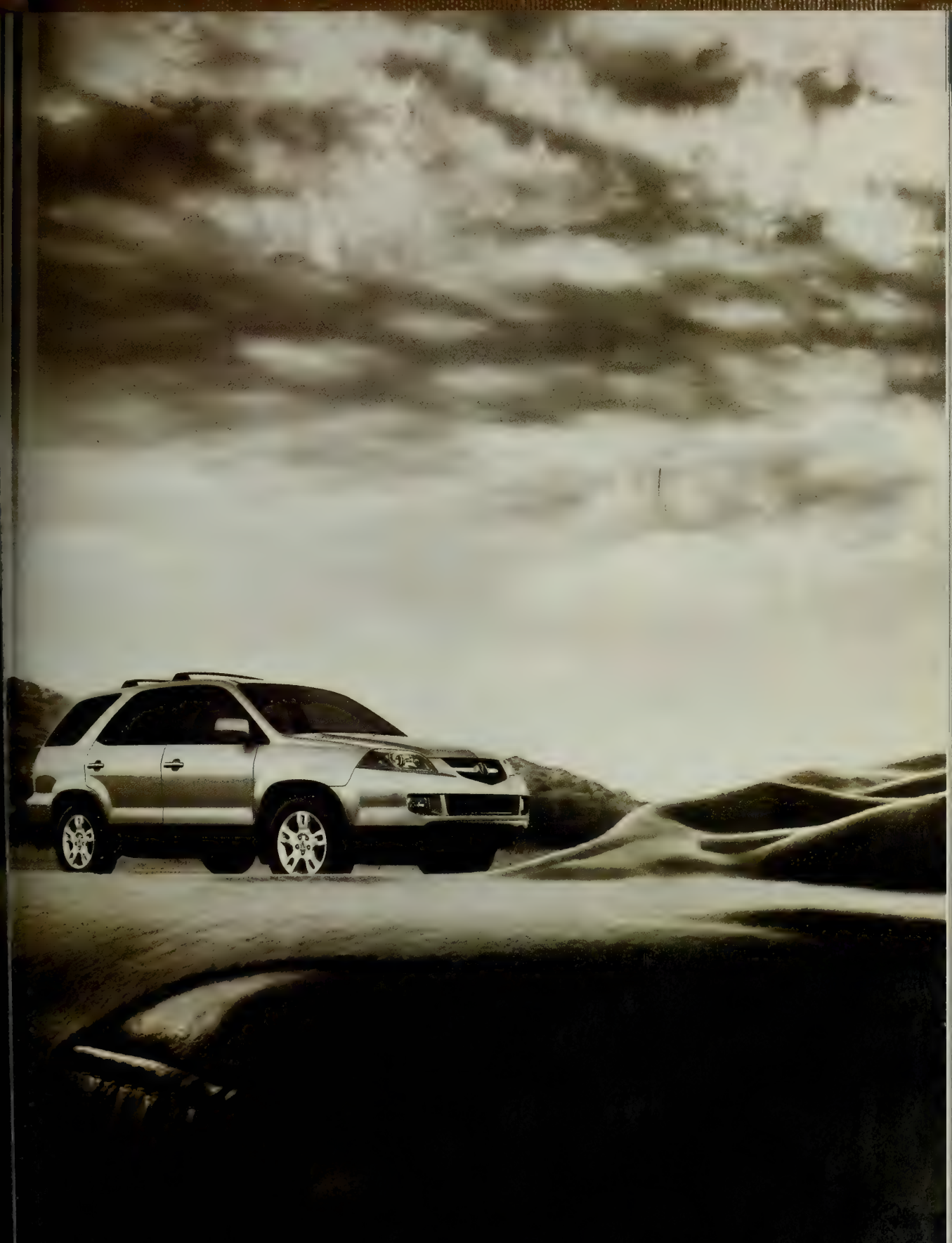
Difficult politics and increasing are about to kick in as Verizon bro its campaign—not to mention its b to face down fierce counter-tactics cable giants. So Verizon executive not want to extrapolate too much the honeymoon in Keller. ■

Winning Over Keller's Couch Potatoes

To promote its new TV service in a suburban Texas town, Verizon has:

- Worked with ESPN to help set up a mock SportsCenter booth outside heavily attended local high school football games where people could record their own broadcasts as a lure to showcase Verizon's superfast fiber optic lines.
- Staged musical performances and a design contest for youngsters to display their work online. Verizon also sponsors a game lab where kids can use 30 souped-up Alienware computers.
- Promoted itself on pizza boxes, fast-food cups, and Chinese food containers. Hummers draped with Verizon banners cruised Keller's streets, and planes towed banners overhead.
- Signed up a local custom video business to showcase the service through monster high-def screens and high-end speakers.
- Pitched its service door-to-door like the Fuller Brush Man of old.

Data: Verizon Corp.



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ENRON

SOMETHING A JURY CAN SEE

The Global Galactic agreement could be a smoking gun

BY MICHAEL OREY

COURTROOM testimony about you can hurt. But it's often the stuff that's in writing that can really kill you. In countless cases it has been egregious e-mails, malevolent memos, or other damning documents—not testimony—that has sent a defendant's case down in flames. In the federal prosecution of Kenneth L. Lay and Jeffrey K. Skilling for their role in the collapse of Enron Corp., that kind of documentary evidence has been lacking. Until, perhaps, now.

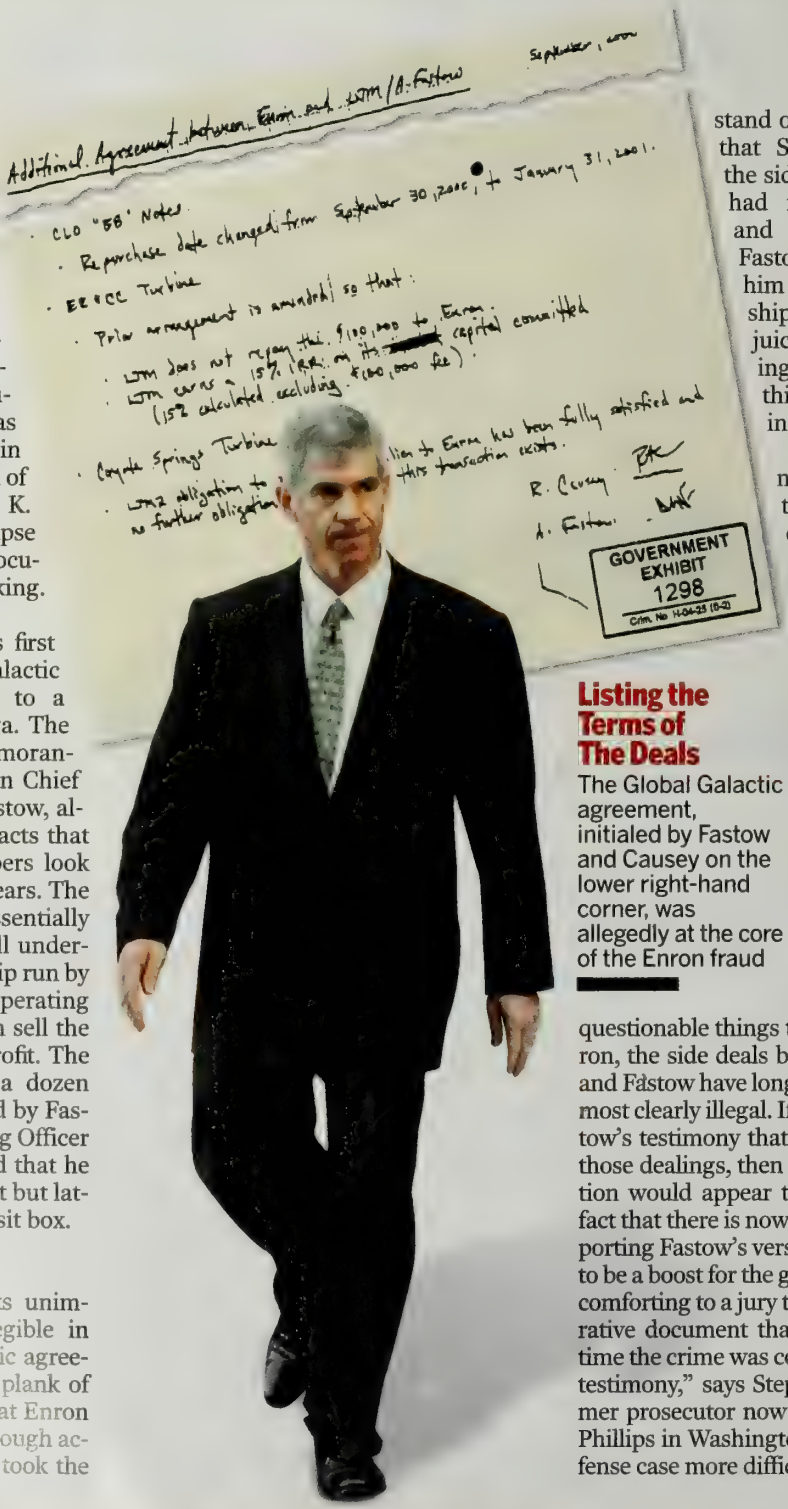
On Mar. 7 the world got its first look at the so-called Global Galactic agreement—the closest thing to a smoking gun in the Enron saga. The three-page, handwritten memorandum, authored by former Enron Chief Financial Officer Andrew S. Fastow, allegedly documents the secret pacts that made the energy giant's numbers look deceptively good for so many years. The deals, the government claims, essentially went like this: Enron would sell underperforming assets to a partnership run by Fastow, claim the proceeds as operating income, and Fastow would then sell the assets back for a guaranteed profit. The agreement lists the terms of a dozen deals and appears to be initialed by Fastow and former Chief Accounting Officer Richard Causey. Fastow testified that he destroyed the original document but later found a copy in his safe deposit box.

MATCHING TESTIMONY

WHILE THE DOCUMENT looks unimpressive—indeed, it's barely legible in some places—the Global Galactic agreement appears to support a key plank of the Justice Dept.'s argument: that Enron was manufacturing earnings through accounting games. When Fastow took the stand on Mar. 7, he tes that Skilling knew a the side agreement th had inked with Ca and fully supporte Fastow said Skilling him to use the par ships to "give me a juice you can" on ings. "We were this to inflate our ings," Fastow test

In his cross-ex nation, Skilling' torney, Daniel celli, hammered at Fastow's cred ty, portraying former CFO thief who without his b knowledge. ther Skilling' Lay's name the Global Ga agreement.

The case's come may de on whose ve of the Global tic story the finds most cre Among the questionable things that happened a ron, the side deals between the com and Fastow have long been consider most clearly illegal. If the jury accept tow's testimony that Skilling knew those dealings, then the odds of a co tion would appear to increase. An fact that there is now a piece of pape porting Fastow's version of events is to be a boost for the government. "It' comforting to a jury that there's a co rative document that was created time the crime was committed that f testimony," says Stephen M. Ryan, mer prosecutor now at Manatt, Phe Phillips in Washington. "It makes t fense case more difficult."



Listing the Terms of The Deals
The Global Galactic agreement, initialed by Fastow and Causey on the lower right-hand corner, was allegedly at the core of the Enron fraud

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THE WORKPLACE

BACKGROUND CHECKS THAT NEVER END

A new security outfit takes a close look at potential hires, and then keeps on looking

BY JENA McGREGOR

POPULAR ONline grocery company Fresh Direct, which delivers provisions to armies of apartment-dwelling New Yorkers, suffered a troubling blow in late 2004. One of its drivers was charged with, and later pled guilty to, stalking and harassing female customers. The background investigation that Fresh Direct's screening firm had performed on the employee hadn't revealed previous misdemeanor and felony convictions on the driver's record.

Jim Moore, Fresh Direct's senior vice-president for human resources, quickly switched to a new background-checking outfit. A few months later he tapped a third, a startup called Verified Person, which sends automated biweekly updates to Moore that alert him to any new misdemeanor or felony convictions of the company's employees. Anyone from CEO Dean Furbush to the company's drivers and food packagers is subject to the search. "We want to be seen as being ultra-vigilant," says Moore.

Verified Person, cofounded by John Sculley, former chairman of Apple Computer Inc. and ex-CEO of PepsiCo Inc., and Tal Moise, a former chief information officer at Clarian Health Partners in Indianapolis, claims to be the first company to offer continuous employee screening, with automatic updates. "John's core interest and mine was that the background-screening sector had shown little innovation," says Moise. It began marketing the service in 2005.

With September 11 and corporate scandals leading to greater worker scrutiny, pre-employment background checks are routine in many industries. But as technology advancements improve the accuracy of searches and more state and local records become digitized, continuous screening could turn into a big business, too. "It's the logical next generation of the background-checking phenomenon," says Garry Mathiason, a se partner at San Francisco employmen firm Littler Mendelson.

Automated, ongoing screening is news for employers in industries su financial services that have statutes hibiting employees convicted of ce crimes from being on the payroll. E could be bad news for white-collar w ers who would rather not have their ployers discover a minor pot bu drunk driving charge.

WIDE-RANGING SEARCHES

VERIFIED PERSON HAS its sights se larger market. In mid-March a te management software firm called Corp., which works with 62 co nies in the Standard & Poor's stock index, will start off Verified Person's servic its clients. Verified Pe charges $1 to $2 per m per employee screened. not yet profitable, it estir that total revenues wil $10 million this year.

Continuous screeni bound to feel a little inv to many cubicle dwe even if it's nice to know isn't a thief—or worse over that burlap-and-mela partition. "Very few employers the background information the lect to the requirements of the job," Lewis Maltby, president of the non National Workrights Institute. Even employer doesn't take action wh turns up records of a DUI or minor possession, "once you know someon a criminal conviction, it colors you ception of them," says Maltby. Ve Person says one-third of the 50 clien ing its continuous service limit the ber of offenses searched.

It's hard not to see a trace of irony founder John Sculley's new venture days after leaving Apple in 1993, S joined a Manhasset (N.Y.) wireless co ny called Spectru formation Techno as chairman and Had he done a tho check, he might found that the Sec & Exchange Comm was investigating company for exag ing the amount of ties it expected fro censing deal. He le four months, and trum ultimately sett

To Snoop Or Not To Snoop

Industries that may benefit most from ongoing employee screening:

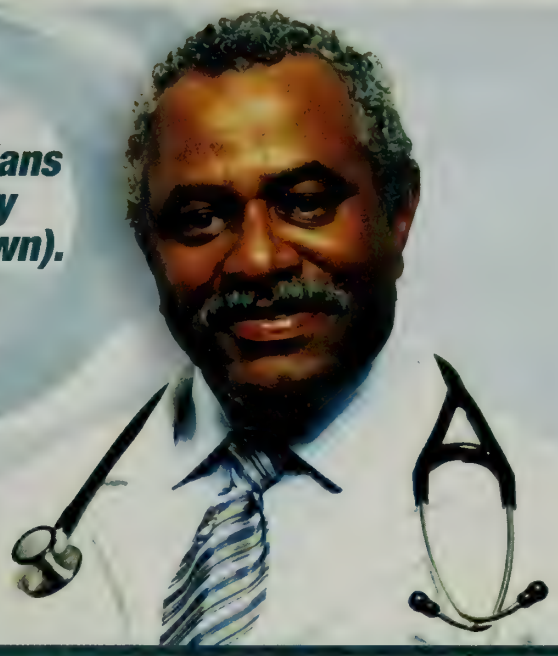
HEALTH CARE, CHILD CARE, ELDER CARE Each state requires pre-hire background checks for at least one of these fields. Crimes committed post-hire could be considered negligent retention.

FINANCIAL SERVICES Insurance companies and banks prohibit certain felons from being employees or contractors.

DELIVERY SERVICES, IN-HOME CONTRACTORS Any field where workers come in close contact with the public is at high risk of being held liable for employee crimes.

According to a recent physician survey,*

LIPITOR is the #1 choice of physicians to treat high cholesterol (especially when it comes to lowering their own).



For years, LIPITOR® has been helping millions of people lower their cholesterol. And according to a recent survey of physicians who take a prescription medicine to lower their own cholesterol, LIPITOR is far and away their #1 choice, too. And, in the same survey, more cardiologists said that they would prescribe LIPITOR for their own family members than any other cholesterol-lowering brand. Ask your doctor today if LIPITOR, the #1 prescribed cholesterol medicine in the world, is right for you. Call us at 1-888-LIPITOR (1-888-547-4867). Find us on the web at www.lipitor.com

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IMPORTANT INFORMATION:

LIPITOR® (atorvastatin calcium) is a prescription drug. It is used in patients with multiple risk factors for heart disease such as family history, high blood pressure, age 55 or older, low HDL or smoking to reduce the risk of heart attack and stroke and, along with a low-fat diet, to lower cholesterol.

It is also used in patients with type 2 diabetes and at least one other risk factor for heart disease such as high blood pressure, smoking or complications of diabetes, including eye disease and protein in urine, to reduce the risk of heart attack and stroke.

LIPITOR is not for everyone. It is not for those with liver problems. And it is not for women who are nursing, pregnant or may become pregnant.

If you take LIPITOR, tell your doctor if you feel any new muscle pain or weakness. This could be a sign of serious muscle side effects. Tell your doctor about all the medicines you take. This may help avoid serious drug interactions. Your doctor should do blood tests to check your liver function before and during treatment and may adjust your dose. The most common side effects are gas, constipation, stomach pain and heartburn. They tend to be mild and often go away.

Please see additional important information on next page.

LIPITOR is one of many cholesterol-lowering treatment options in addition to diet and exercise that you and your doctor can consider.

*Results are based on a subset of a blinded, national, random survey of 694 physicians representative of the AMA master file, conducted by Harris Interactive Inc. from April 25, 2005 through June 17, 2005.

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IMPORTANT FACTS

(LIP-ih-tore)

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High cholesterol is more than just a number, it's a risk factor that should not be ignored. If your doctor said you have high cholesterol, you may be at an increased risk for heart attack. But the good news is, you can take steps to lower your cholesterol.

With the help of your doctor and a cholesterol-lowering medicine like LIPITOR, along with diet and exercise, you could be on your way to lowering your cholesterol.

Ready to start eating right and exercising more? Talk to your doctor and visit the American Heart Association at www.americanheart.org.

WHO IS LIPITOR FOR?

Who can take LIPITOR:

- People who cannot lower their cholesterol enough with diet and exercise
- Adults and children over 10

Who should NOT take LIPITOR:

- Women who are pregnant, may be pregnant, or may become pregnant. LIPITOR may harm your unborn baby. If you become pregnant, stop LIPITOR and call your doctor right away.
- Women who are breast-feeding. LIPITOR can pass into your breast milk and may harm your baby.
- People with liver problems
- People allergic to anything in LIPITOR

BEFORE YOU START LIPITOR

Tell your doctor:

- About all medications you take, including prescriptions, over-the-counter medications, vitamins, and herbal supplements
- If you have muscle aches or weakness
- If you drink more than 2 alcoholic drinks a day
- If you have diabetes or kidney problems
- If you have a thyroid problem

ABOUT LIPITOR

LIPITOR is a prescription medicine. Along with diet and exercise, it lowers "bad" cholesterol in your blood. It can also raise "good" cholesterol (HDL-C).

LIPITOR can lower the risk of heart attack or stroke in patients who have risk factors for heart disease such as:

- age, smoking, high blood pressure, low HDL-C, heart disease in the family, *or*
- diabetes with risk factor such as eye problems, kidney problems, smoking, or high blood pressure

LP268415-H

POSSIBLE SIDE EFFECTS OF LIPITOR

Serious side effects in a small number of people:

- **Muscle problems** that can lead to kidney problems, including kidney failure. Your chance for muscle problems is higher if you take certain other medicines with LIPITOR.
- **Liver problems**. Your doctor may do blood tests to check your liver before you start LIPITOR and while you are taking it.

Symptoms of muscle or liver problems include:

- Unexplained muscle weakness or pain, especially if you have a fever or feel very tired
- Nausea, vomiting, or stomach pain
- Brown or dark-colored urine
- Feeling more tired than usual
- Your skin and the whites of your eyes turn yellow

If you have these symptoms, call your doctor right away.

The most common side effects of LIPITOR are:

- Headache
- Diarrhea, gas
- Rash
- Constipation
- Upset stomach and stomach pain
- Muscle and joint pain

Side effects are usually mild and may go away by themselves. Fewer than 3 people out of 100 stopped taking LIPITOR because of side effects.

HOW TO TAKE LIPITOR

Do:

- Take LIPITOR as prescribed by your doctor.
- Try to eat heart-healthy foods while you take LIPITOR.
- Take LIPITOR at any time of day, with or without food.
- If you miss a dose, take it as soon as you remember. But if it has been more than 12 hours since your missed dose, wait. Take the next dose at your regular time.

Don't:

- Do not change or stop your dose before talking to your doctor.
- Do not start new medicines before talking to your doctor.
- Do not give your LIPITOR to other people. It may harm them even if your problems are the same.
- Do not break the tablet.

NEED MORE INFORMATION?

- Ask your doctor or health care provider.
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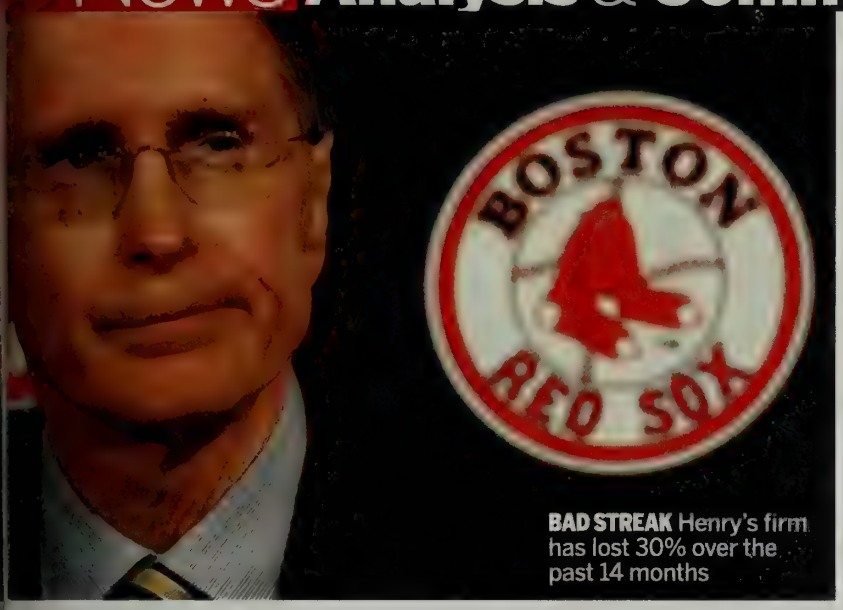


BAD STREAK Henry's firm has lost 30% over the past 14 months

NEY MANAGEMENT

URSE OF THE BAMBINO N THE TRADING FLOOR?

d Sox owner John Henry's futures nds are in a serious slump

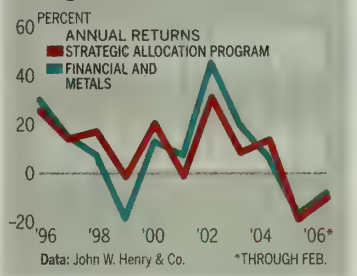
ILLIAM C. SYMONDS

JOHN W. HENRY, THE FAMED futures trader and principal owner of the Boston Red Sox, was the king of Beantown in October, 2004, when his Sox won the World Series and broke the most fabled in sports. But he has been in a ful slump ever since. In 2005, Henry's 11 managed futures posted double-digit losses. And hose losses extending through Feb- his firm has shed $1 billion in as- own 30% from the peak at the end 4, when stray pieces of confetti still d the Boston streets. "This is a business," says Henry, who figures retch "may well [be] the worst" he launched his firm, John W. & Co., in 1982.

Hry is famous for delivering long- esults. "He is one of the all-time ge- , and his track record has been ex- inary," says John Damgard, ent of the Futures Industry Assn. er the recent hitless streak, Henry's batting average has dipped. The Strategic Allocation Program, his biggest fund, lost 19.2% in 2005 and an additional 10% through February (chart). Its annualized compound return through the end of last month was just 8.63% since the fund's inception a decade ago, a smidge below the 8.64% gain of the Standard & Poor's 500-stock index over that period.

JOHN HENRY STRIKES OUT

Results for Henry's two largest funds



Data: John W. Henry & Co. *THROUGH FEB.

Has the curse of the Bambino been transferred from the Sox to their owner? Has Henry taken his eye off the ball? He laughs off such thoughts. "Our business is very cyclical," he says, "and we go through periods where we just can't do anything right." Henry is confident, however, that he'll turn things around.

But the Achilles' heel of long-term trend followers is a range-bound market with no clear direction. Interest rates and currencies, where he invests some 70% of his money, fit that description right now. "When neither one is working, we aren't going to do well," says Henry.

LIGHT ON SUGAR

LAST YEAR, HENRY whiffed on 30-year Treasury futures when his trading model identified trends that didn't pan out. And he bet on higher natural gas prices only to be blindsided when a warm December led to a drop. "Henry did poorly," says Sol Waksman, president of Iowa-based Barclay Group, which tracks managed futures and hedge funds. "But he was not alone.... [Many] trend followers had a very bad year."

Henry was also hurt by his risk management strategies. Prices of sugar, copper, and gold all surged last year. But because those markets are far more volatile than currencies and interest rates, "we don't allocate much money to them," says Mark S. Rzepczynski, president of the Boca Raton (Fla.)-based firm and the man who runs things on a day-to-day basis. Sugar futures made up less than half a percent of Henry's holdings in 2005.

Not that investors are bolting in droves. All the red ink "hasn't shaken my confidence," says Peter Lamoureux, president of Iowa-based Everest Asset Management Inc. "In fact, I added money on Mar. 1, and if they don't come back in March, I will add more on Apr. 1."

One reason for the loyalty is that Henry's funds have proven to be good diversification tools. During the bursting of the tech bubble, Henry's Strategic Allocation Program surged 53.5%, while the NASDAQ was cut in half. And in the months before the current war in Iraq, Henry's Financial & Metals Portfolio rose 91.6%, while the S&P 500 fell 25.5%.

Can he post those kinds of gains again? "No one can predict the future," says Henry. But he suspects that the dollar, oil, and interest rate markets will eventually break out of their trading ranges, creating some new opportunities.

Until then, the firm is pulling in its horns. But count on Henry & Co. to come charging out of the dugout as soon as clear trends emerge, curse or no curse. ■

BusinessWeek online To read what John Henry thinks about the Yankees, visit www.businessweek.com/extras.

MARKETING

A BILLION TOUGH SELLS

The Chinese car buyer is very demanding in a ferocious competitive market. Sales tactics are racing to catch up

BY BRIAN BREMNER AND DEXTER ROBERTS

ZHANG GUANGMING'S car-buying synapses have been in overdrive for months. He has spent hours poring over Chinese car buff magazines, surfing Web sites to mine data on various models, and trekking out to a dozen dealerships across Beijing. Finally, Zhang settled on either a Volkswagen Bora or a Hyundai Sonata sedan. But with cutthroat competition forcing dealers to slash prices, he's not sure whether to buy now or wait. Another snag: His $18,500 budget might not fetch the combination of design and drivability he covets. "I am looking for the best engine performance," the 30-year-old trading company manager says while ogling a blue Bora at a Beijing VW dealer. "And it can't be too ugly. Style is important."

So make that an economy sedan with high-end performance and bodacious styling that's priced low enough to retain its value despite corrosive price deflation. If Zhang sounds a bit picky, well, he's not too different from most of his car-buying peers on the mainland. Both foreign and domestic auto makers are quickly discovering that while 84% of new-car sales in China are to first-time buyers, those folks are anything but naive. "Chinese b are very demanding and not ver giving," says John Humphrey, the aging director in charge of China ations at J.D. Power & Associate (like *BusinessWeek*, a unit of Th Graw-Hill Companies).

That's a problem for U.S., Eur and Asian carmakers. Manufac from across the globe have investe lions of dollars in new plants in The prize: a share of the world's m namic auto market. Last year pass car sales in China jumped 26%, to 3 lion vehicles. The mainland is no world's No. 3 auto market after th

Japan. This year, sales expected to grow 12%), compared with no in- se in the U.S.

he competition is fierce. nany as 100 domestic 10 foreign manufactur- re slugging it out. Con- ers can now select about 25 entry-level pacts such as the Chery nd Honda Motor Co.'s Not enough choice? her 25 new models— subcompacts to SUVs—are due out year. That may be great for con- ers, but it's murder on manufactur- The average price for a compact in a has fallen by 28% since 2000, e other categories are off by more 20%, J.D. Power says. "China used to be a very profitable market for everyone," but growing competition has eaten into earnings, says Yoshimi Inaba, Toyota Motor .'s executive vice-president in ge of China.

G, BUT...
e most
an't afford
picky

r Toyota and its rivals, cracking the on Chinese buying habits is crucial. can be tricky. With so many first- buyers, there's little brand awareness lmost no brand loyalty. Middle-class ese often spend more than a year's ne for even a low-end car, and 89% n cash, J.D. Power data show. About of all Chinese buyers rely on the ons of family and friends when mak- his critical purchase. That means g a dud isn't just disappointing. It's huge loss of face for both the buyer nyone who offered advice. Another : One-third of Chinese rate engine ransmission performance as their priority, vs. only 19% in the U.S. and India. A car "has to have an ener- heart," insists Luo Changyi, a 24- old Beijing resident who drives a wagen Golf.

auto makers, those idiosyncrasies r some innovative tactics. General s Corp. advertises heavily on MTV act younger customers in a market the median age of car buyers is 35, in the U.S. GM displayed its Chevy sedan at last year's MTV music s show in China, and MTV has lined inese pop stars for GM promotions. fort seems to be working: GM last vertook VW as the top-selling man- rer on the mainland. "We have a , energetic family buyer, so this ap- o them," says Chevrolet Brand Director Dale Sullivan.

THE STAT

84%

of new car sales in China are to first-time buyers. In the U.S., just **1%** are.

Data: J.D. Power & Associates Inc.

Chinese brands are jumping in with their own marketing gimmicks. Geely Automobile Holdings Ltd. sponsors owners' clubs, which help build brand loyalty and all-important word-of-mouth advertising. Prospective buyers "will stop a person parking a Geely and ask them: 'What do you think of this car?'" says Geely Executive Director Lawrence Ang. Last year a pair of company engineers joined Geely drivers on a 300-mile journey from Beijing to Inner Mongolia to teach the owners how to handle their cars in rough conditions. "The most effective marketing is to treat your existing customers very well," Ang says.

Nissan Motor Co. would agree with that. To make sure its customers stay happy, Nissan three years ago dispatched six retired dealership executives from Japan to help improve showroom cleanliness, interaction with customers, and after-sales service. The payoff? Nissan dealers in China ranked No. 1 in customer service for 2005, according to J.D. Power. That matters since even routine maintenance problems can be a brand-killer in a market of newbie drivers. Says Yasuaki Hashimoto, who oversees Nissan's sales in China: "We want our first-time buyers to be second- and third-time ones." ■

–With Ian Rowley in Tokyo

LOOKING FOR DEALS But buyers remain suspicious about secondhand wheels

NEW BUSINESS

Kicking Used Tires

How many new cars does it take to make a used-car market? For years, anyone in China wanting a set of wheels pretty much had to go to a new-car dealer. Why? Because as recently as a decade ago, Chinese bought just 300,000 new cars annually. And without a lot of new cars, it's hard to have many used ones.

But in 2005, Chinese consumers bought 3.1 million new cars and have purchased more than 1 million vehicles annually since 2002. That has led to a growing market for secondhand vehicles—more than 1.25 million last year. Used cars "are much cheaper, and the condition is still very good," says 21-year-old Gong Jianmin, who expects to spend $12,000 for a five-year-old VW Jetta. "For me, that's a deal."

Used cars are poised to become a much bigger deal. In the U.S. and Europe, as many as three used cars are sold for every new one, so there's plenty of room for growth in China. And new regulations approved in October make it easier and less costly to transfer ownership of a car.

That has led a host of foreign auto companies to jump into the business. General Motors, VW, Audi, BMW, and Toyota Motor all have authorized dealers to sell their cars used, which should boost trade-ins and increase consumer confidence. But the business isn't easy, particularly given buyer suspicions about secondhand cars and those who sell them. Just ask Meng Qingkai, manager of the used-car department at Beijing Dashihang Auto Sales Co. Although he says customers trust his company because it's an authorized Buick outlet, he allows that other shops "cheat consumers." China's market for secondhand vehicles may be nascent, but its reputation, at least, is apparently little different from the used-car business worldwide.

–Dexter Roberts

SPARRING PARTNER Vinje sees Microsoft's exploits as a bid to control the Internet

EUROPE

SPEAK SOFTLY AND CARRY A THICK BRIEF

Donnish litigator Thomas Vinje is Microsoft's most tenacious adversary

BY JACK EWING

THOMAS VINJE DOESN'T come across as the kind of guy who would drive Microsoft Corp. crazy. Soft-spoken, shy, and intellectual by nature, the 52-year-old Vinje (pronounced Vin-ya) seems more like a professor than a high-powered lawyer who spends much of his waking hours taking on Microsoft.

Yet Vinje's bite is far worse than his bark. In his 16-year battle to pressure Microsoft to curb what the lawyer perceives as its anticompetitive tendencies in Europe, he has been point man for such competitors as Oracle Corp. and Sun Microsystems Inc. A partner in the Brussels office of multinational law firm Clifford Chance LLP, Vinje played a key role in persuading the European Commission to fine Microsoft more than $600 million in 2004 for abusing its dominance of PC operating systems. On Feb. 22 an industry group represented by Vinje filed a new complaint with the EC accusing Microsoft of plotting to dominate the Internet with new software, thus forcing out competition from the likes of Linux, the free operating system that competes with Windows. "It seems painfully obvious to me that's what it is all about," Vinje says.

The latest complaint, a year in the making, opens up a new front in the war against Microsoft. It accuses the com of planning to use soon-to-be-rele products such as Vista, the next versi Windows, as well as upcoming Win server software, and a new version fice, to fence off ever bigger parts software universe. The complaint, n public, argues that Microsoft pla combine its new PC and server oper systems with its own software for cre Web applications and managing co rights. By bundling in its own proc or offering them at too-good-to-r prices, Microsoft could ruin the m for competitors such as Adobe Sy Inc., according to Vinje. He also w that Microsoft is trying to weaken standards on the Net, forcing Web opers toward Microsoft's proprieta proaches. Says Vinje: "It means Mic gains control of the Web."

"VERY TOUGH"

FOR MICROSOFT, which denies it ing to create any kind of monopol complaint is a major headache as th ware giant readies new products. Th son, as much as anything, is Vinje self. "He can be very tough," sa Black, president of the Computer & munications Industry Assn., which ployed Vinje to represent it in E during the long-running battle wit crosoft. "He's not looking to pick fig personality and style, but will abso pick them on substance."

Vinje is known as a master of rh who can easily summarize highly t cal issues in ways that EU officials c derstand. He has years of experie intellectual property and antitrust l also has been able to hold togeth coalition of companies that finan anti-Microsoft fight, ranging from like Oracle to relatively small com such as Norway's Opera, which Web browsers for mobile phones.

Microsoft portrays Vinje as the compensated front man in a crus

Man vs. Microsoft

American-born lawyer Thomas Vinje has b dogged in his pursuit of the software giant.

1989 Co-founded European Committee on Interoperable Systems (ECIS) to represent interests of companies such as Nokia, Fujitsu, and NCR before the European Union

1999 Hired by Computer & Communications Industry of America to pursue antitrust claims against Microsoft in the European Union

2004 Instrumental in convincing European Commission to sanction Microsoft and order it t reveal software specs t competitors

2006 Files new compla on behalf of ECIS accu Microsoft of planning t not-yet-released softw to dominate the Intern

Data: Vinje, Bu

IVEST JAPAN
Government of Japan

JAPAN – OPPORTUNITY IS RISING

Are you ready to do business in the country that leads Asia in consumer trends? Renowned for setting the tone for an entire continent – especially in the fashion and luxury brand sectors – a resurgent Japan is riding the economy's current dramatic upturn. There's simply no better Asian market for direct investment opportunities.

ader in consumer trends the region

n is unquestionably one of the world's al trend setters – especially in Asia. ntire region looks to Japan to set the rend in fashion, luxury and lifestyle – nomenon from which many marketers enefit.

most discerning and loyal omers in the world – high discretionary income

ere in Asia will you find such a wide of customers more willing to commit rust and disposable income to a brand. Both able and willing to pay nium for excellence, they ensure that marketing yen yields a great return.

A geographically concentrated consumer base is a dream for marketers

Japan is the world's second largest economy in an area smaller than California. This unique concentration of consumer purchasing power enables rapid scaling of business from both a distribution and communication perspective.

The Japanese workforce: Legendary for dedication, loyalty and, most importantly, getting results

Japan is also unique for the high quality of its human capital. While increased mobility enables foreign companies to hire skilled employees from anywhere, the dedication and loyalty of highly educated local workforces are unquestioned.

242 year old French luxury brand found more than just a demand for its al in Japan. Thanks to strong top store relationships, excellent distribution bold marketing strategy, Baccarat has been able to expand its appeal gh tabletop, jewelry and fashion accessories to an audience that recognizes ty and true value, while remaining the premier choice for corporate gifting. rat's sales in Japan account for 35% of the brand's worldwide total.

"It's a gift for Baccarat to have such a discerning, sophisticated and loyal audience as the Japanese. Their trust and appreciation of our brand has allowed us to grow across a variety of retail platforms throughout our 20 years in this market."

Marc LeClerc,
Worldwide CEO

Baccarat

- Intellectual Property Protection, Political Stability – Japan has ual property rights in place to ensure that investors needn't worry about nt infringement or cheap copying of products. Moreover, Japan's political has been extremely stable for over 60 years, making for a healthy, free business environment.

- More Reasonable Market Entry Costs – The advent of improved services eased price competition in areas such as telecommunications, including nd, have significantly reduced business infrastructure costs, while real estate ave consistently decreased since 1992. Meaning start-ups start a lot easier.

JAPAN - ***A Highly Advanced Test Market*** – The Japanese are among the most discerning consumers in the world. Successful products developed under fierce competition in this market are therefore expected to prevail throughout Asia and beyond.

JAPAN - ***Transforming Business Environment*** – Advances in structural reform have buoyed the economy. Old business practices, such as lifetime employment and keiretsu, are being phased out, while improved corporate governance creates a favorable investment climate for foreign companies.

The opportunities are there. The time is now. Japan is open for business. Especially yours.

Ministry of Economy, Trade and Industry

JETRO (Japan External Trade Organization) is a Japanese government-related organization that promotes trade and investment. For information and support to companies looking to bring a business or expand in the Japanese market, please visit **www.jetro.org/opportunity**.

IBM and other rivals to hurt its business. "They are a very small group of companies with a very clear business interest in keeping Microsoft harassed by the regulatory process," says Horacio E. Gutiérrez, associate general counsel for Microsoft in Europe. Yet the software titan has been sparring with Vinje for much of its corporate history. In 1989, San Francisco-based law firm Morrison & Foerster LLP sent him to Brussels to represent tech clients such as Fujitsu Ltd. and NCR Corp. concerned about European software law.

THE LONG CRUSADE

SOON AFTER, VINJE HELPED found the European Committee for Interoperable Systems, lobbying on behalf of clients such as Nokia Corp. on early software regulation. That led to enormous clashes with Microsoft over ground rules for companies to reverse-engineer one another's software in order to create compatible programs. The struggle culminated in landmark legislation in 1991. "If dominant companies throw their weight around to avoid competition, that's a bad thing," says Vinje, who cites his youthful travels through the Soviet bloc as a lesson in how monopolies impede markets.

Microsoft sees Vinje as front man for rivals like IBM

Vinje's crusade against Microsoft went into high gear in 1999, when he argued the competitors' case before the European Commission, the EU's administrative arm. It took five years of hearings and written arguments before the commission levied its now-famous fine in 2004. The decision was a huge win for Microsoft antagonists. But they can't claim victory yet. Microsoft has appealed the decision, which will be heard by the EU'S Court of First Instance in April, and still hasn't given over all the technical information competitors say they need.

Vinje could have years more of 12-hour days as a result. That's O.K., he says, if it means bringing Microsoft to heel. "It's not that I hate Microsoft or want to destroy Microsoft. It's not personal," he says. "What I would like them to do is compete on the merits." For Microsoft, making Thomas Vinje go away is no easy task. ■

KOREA

HANDS ACROSS THE DMZ

North Korea has what South Korea wants

NEW JOBS: the Kaesc Industrial Complex

BY MOON IHLWAN

FOR DECADES, THERE HAS not been much traffic across the demilitarized zone dividing North and South Korea, where hundreds of thousands of soldiers are on constant alert. But these days, some 200 cars, trucks, and buses cross the border every day.

They're going to the Kaesong Industrial Complex, a dusty outpost that is North Korea's boldest economic initiative in decades. Just an hour north of Seoul, Kaesong is cordoned off from the rest of North Korea by seven-foot-high fences patrolled by squads of soldiers.

Just after 7:00 a.m., Monday through Saturday, dozens of buses from North Korea enter Kaesong, ferrying some 6,000 northern workers to 11 South Korean-owned factories to make shoes, clothing, pots, and other low-tech goods. Another 28 South Korean outfits have signed agreements to set up plants there, while 1,000 more are considering such a move, the Seoul government says.

The idea behind the effort is simple: North Korea is home to a huge, cheap, and underemployed workforce. South Korea needs a low-wage manufacturing base to compete with China. By 2012, Kaesong could be home to 725,000 jobs and generate $500 million in wages annually for the North Korean economy, figures Park Suhk Sam, senior economist at Bank of Korea. After a five-year tax holiday expires, another $1.8 billion might tumble in annually from corporate taxes levied on South Korean companies operating there. "The overall impact on the North will be huge," Park says.

North Korea's "Dear Leader," Kim Jong Il, has little choice but to experimen en the dire condition of the N economy. True, Kim's first priority litical self-preservation, so any op will be measured. But since 2002 embraced—however grudgingly- tative economic reforms. State-c farms and factories that exceed pr tion targets are now rewarded higher wages. And Pyongyang eased price controls and opened p markets where food and cons goods are sold. "North Korea is pu ahead with changes extent that they wil jeopardize its regime,' Paik Hak Soon, a secur pert at the Sejong Insti Seoul think tank.

For South Korean c nies, Kaesong offers pl advantages. North K workers at Kaesong about $50 a month, a half the average wage f skilled workers in Chi less than 10% of what Koreans earn. Kaeson fers better business tions than China," says Moon Seop, president of shoemaker Sa Stafild. The company has investe million in its spotless Kaesong f where some 1,200 workers cu stitch shoes.

Outsourced work for South capitalists may not be exactly wha and Engels—or Kim Il Sung (Kir Il's father)—had in mind, but it c the only hope for Pyongyang. ■

Two Koreas

GDP per capita

SOUTH	$20,300
NORTH	$1,800

Based on purchasing power parity
Data: CIA World Factbook

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Debt Valley Days

Techdom is making a lot more use of that old-school financial tool, the bond market

BY DAVID HENRY

SILICON VALLEY IS FAMOUS for its gizmo gurus, the men and women who dream up disruptive technologies and killer apps. For most of the 1990s, they were a big reason why shares of tech companies seemed to defy gravity. But lately, tech companies are relying increasingly not on electrical or software engineers to drive their stock prices but on financial engineers.

They have little choice. Revenue growth has fallen to around 10% a year, half the rates of the go-go '90s. That slowdown has turned tech shares into laggards. The info tech stocks in the Standard & Poor's 500-stock index have gained just 5% since December, 2003, vs. 15% for the whole index.

And so, for better or worse, tech companies are putting aside their long-standing aversion to debt in order to execute share buybacks, issue dividends, and make acquisitions to juice their share prices. Cisco Systems Inc., the big communications gear vendor, in February obtained a credit rating for the first time and sold bonds to raise $6.5 billion in what is thought to be the biggest-ever tech debt offering. The proceeds were more than enough to cover Cisco's $5.1 billion net cash outlay for one of its biggest acquisitions, the February purchase of Scientific-Atlanta Inc., maker of television set-top boxes. Oracle Corp. sold $5.75 billion worth of bonds in January to fund its takeover of rival enterprise software vendor Siebel Systems Inc. Together, the Cisco and Oracle bond sales increased the amount of outstanding investment-grade tech debt by 25%, according to JPMorgan Securities. "Oracle and Cisco are beginning to break new ground," says Laura Conigliaro, stock analyst and leader of the Technology Strategy Research Team at Goldman, Sachs & Co. "In order to create shareholder value, they have to do things that are different."

Other tech players are thinking about following the industry leaders. Symantec Corp. just hired a new debt-savvy CFO from American Airlines Inc. for that very purpose. "Software companies need to think differently about how they use their balance sheets," says Symantec CEO John W. Thompson. "In a consolidating industry, maybe you want to have more debt so you can have more cash and do more things." Eric Ball, Oracle's treasurer, says finance executives are comparing notes and taking calls from investment bankers urging them to tap the hot corporate credit markets. "People disagree on what the appropriate level of debt is, but arguably it is not zero," says Ball.

A new culture of share buybacks and dividends

The trend underscores how extraordinarily easy it is to borrow right now. Investors, especially from Asia and Europe, crave yield any way they can get it. Cisco's deal was way oversubscribed, attracting offers of $20 billion, boasted CEO John T. Chambers at an investment conference on Feb. 28. Oracle, too, turned away money, executives say. Investors are so desperate, in fact, that they're accepting the thinnest yield spreads above Treasury bonds in four decades, says Dan Fuss, vice-chairman and bond fund manager at Loomis-Sayles & Co.

What's more, the change con
Corporate America's long-running
ment toward more leverage—and
credit ratings. The number of U.S.
nancial companies with AAA rati
down to 6 from 32 in 1983, accord
S&P, and many of the downgrades
matters of choice. Some AA comp
are opting to move down, too. In O
DuPont traded its AA rating for a
undertake a $5 billion stock buyba

TESTING THE WATERS

SO FAR, THE BIG tech borrowin
been prudent. Cisco's bonds were
A+ by S&P, which noted that its
less than its earnings before interes
es, depreciation, and amortization
the past 12 months. Oracle's debt
A-, is still only 10% of the com
stock market value of $66 billion. It
flow is 34 times its interest exper

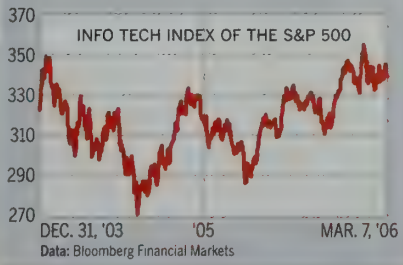
times better than the average cover-
atio for S&P 500 companies, accord-
Merrill Lynch & Co. estimates. Still,
smaller companies are being much
aggressive. Affiliated Computer
es Inc., a Dallas-based data proces-
ok out $5 billion in loans in January
rashed its investment-grade rating
d a buyback of 45% of its stock after
raged buyout plan fell through.

the past, it was the rare tech execu-
ho dared to think about carrying
and for good reason. Product cycles
and went too quickly, and upstarts
red out of nowhere with radical in-
ions to take market share. Stalwarts
Hewlett-Packard, and Motorola oc-
ally sold debt over the years, but
ere exceptions. With tech it's hard
dict who the leaders will be in five
much less 10, when nearly half of
s and Oracle's bonds mature, says Dave Novosel, senior investment analyst at Gimme Credit LLC, an independent research service. Then again, Cisco and Oracle are so firmly established that rapid change isn't such a threat, says Novosel. "They are very large, and [size] brings more stability," he says.

But for the borrowing companies themselves, there is a downside: The stability that bond investors like alienates stock investors who once bid up their shares on rapid growth. Last year, for example, shareholders pressured slow-growing Siebel Systems to do something dramatic to boost its share price. It finally complied, selling out to Oracle in a deal funded by Oracle's bond sale. (Before the Siebel deal closed on Jan. 31, Oracle had spent a large portion of the cash on its balance sheet buying other companies, including rival PeopleSoft Inc.)

TECH IN A RUT

Though the bust is history, info tech stocks still need a boost



Data: Bloomberg Financial Markets

STOCK SUPPORT

BALL, ORACLE'S treasurer, says that as the corporate software industry matures and gets more revenues from recurring fees under service contracts, more companies will likely borrow. They'll use the money to buy competitors or bolster their stocks to avoid being bought.

Cisco is making its own adjustments. Its shares are around $21, just like they were four years ago, when CEO Chambers was talking about growing 30% a year. Now his stated goal is 10% to 15%, and Cisco is using its balance sheet to try to create value. It issued bonds to pay for Scientific-Atlanta after spending one-fourth of its cash pile on $31 billion of share buybacks. Most of Cisco's remaining cash is in Europe and would be taxed if brought back into the U.S. to pay for the takeover or additional buybacks, Chambers told investors at a Goldman Sachs conference on Feb. 28. (Cisco officials declined to comment for this story.) Chambers said that given the tax on repatriating cash, the cheapness of Cisco stock, and the attractive interest rates available in the bond market, it makes sense for Cisco to use leverage. It has said acquiring Scientific-Atlanta will increase earnings per share, albeit "slightly."

During the boom, Chambers could boost profits by reinvesting cash in the business and by issuing the company's hot stock for acquisitions. Cisco shares were trading at twice current levels. Now corporate credit is all the rage, and Chambers is issuing debt. It only makes sense to change with the markets. And issuing debt brings some balance to Cisco's stock-based capital structure. But raising money this way isn't quite the same. Debt, after all, must be repaid. ■

–With Sarah Lacy in San Mateo, Calif.

A Big Chill For Kraft?

If Altria spins off the rest of it, the reception could be cool

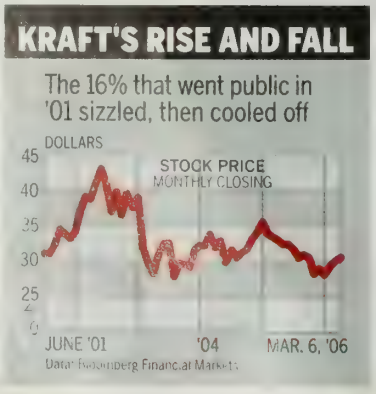
BY ADRIENNE CARTER

FIVE YEARS AGO INVESTORS were crazy for Kraft Foods Inc. It had been off the market since 1988, when tobacco giant Philip Morris Cos., now Altria Group Inc., acquired it. By 2001 tobacco litigation was in full swing, and Kraft's double-digit growth prospects made it too valuable for Altria to keep to itself. The $8.7 billion initial public offering of roughly 16% of Kraft is still the second-largest U.S. IPO ever. Investors pounced on it, sending the stock up 40% in a 12-month period that saw the Standard & Poor's 500-stock index plunge 17%.

Now, Altria may be offering more shares. Management has indicated that it will spin off the rest of Kraft once the tobacco-litigation environment sufficiently improves. In December the Illinois Supreme Court overturned a class-action ruling against Altria, and Florida is expected to rule on another case in the next few months. A favorable judgment could pave the way for Kraft's split from Altria later this year. "If and when Altria decides [to spin off its stake], we'll be ready," says Kraft CEO Roger K. Deromedi.

But some analysts wonder if the market will welcome another helping of Kraft, whose margins have been shredded of late. Shares are down 12% from their 52-week high and trade 4% below the IPO price. If Altria shareholders decide they don't want Kraft, the subsequent sell-off would put more pressure on an already struggling stock.

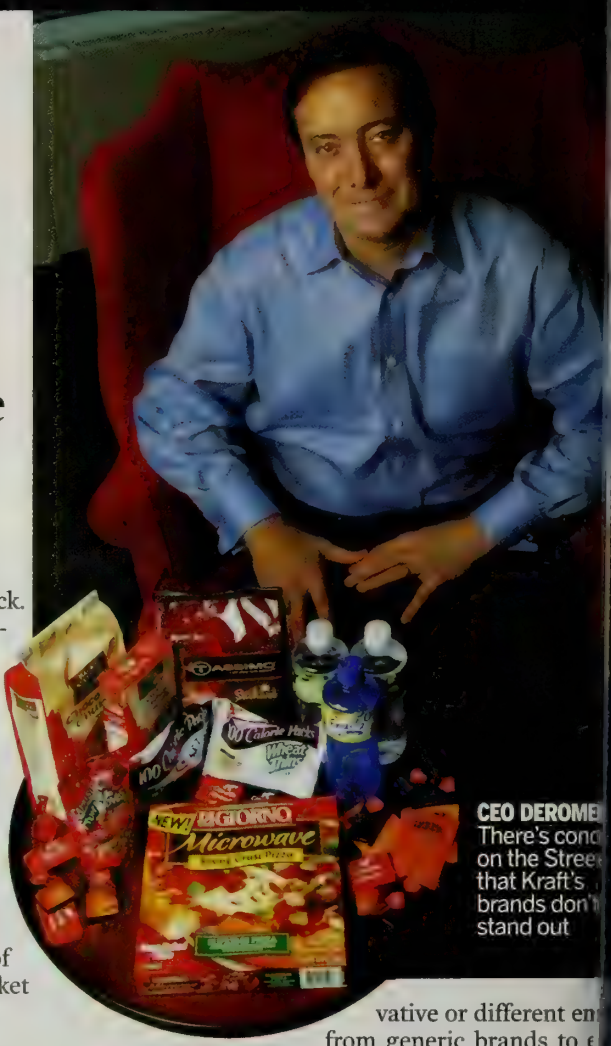
Complicating matters, Altria's now 87% stake in Kraft is worth $43.5 billion. The value of large-cap food stocks in the hands of public investors is roughly $100 billion. So post-spin, Kraft would account for one-third of the industry, a huge hunk of cheese for the market to digest.



TOBACCO REBOUND

IT'S EASY TO understand why Altria holders might not go for Kraft. For one thing, says David J. Adelman, an analyst at Morgan Stanley, the tobacco business is more promising right now, with superior pricing power, stronger brand loyalty, and higher gross margins than food. Altria's stock is also cheaper. Kraft sells for 17 times 2005 earnings; back out the food group from Altria's price-to-earnings ratio of 14, and the implied p-e for the tobacco holdings is 13, vs. 17 for the S&P 500.

What went so wrong for Kraft? It has been ravaged by global competition and rising commodity prices. Operating margins fell from 21% in 2002 to 15% in 2005. Sales by volume barely budged last year. And there's concern on the Street that the company's products are not innovative or different en from generic brands to e consumers to pay up for them. An estimate that earnings will drop $1.72 a share in 2005 to $1.49 this "It's hard to get your stock up whe don't [improve] your earnings," UBS analyst David Palmer.



CEO DEROME There's conc on the Stree that Kraft's brands don't stand out

Kraft's Deromedi says investor recognize the value of the nation's food company. He has spent the pas ple of years shedding lackluster uni cusing on blockbuster brands su Oreo and Oscar Mayer, and buildin ones like South Beach Diet. In Ja Deromedi expanded the comp worldwide restructuring progran nouncing plans to shutter up to 20 plants and trim 8,000 additiona through 2008. Kraft expects to $1.15 billion in annual cost savings such moves, money Deromedi is us invest in product development anc keting. "New products and the proposition of our brands are go help our momentum," says Der "More people are going to want t Kraft stock."

He had better hope so. Otherwise shares may end up in the bargain ai

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LEE Can he turn hidebound EA into a hotbed of creativity?

A Radical New Game Plan

Electronic Arts is ditching tired tie-ins for more daring, interactive video game ideas

BY BURT HELM

VIDEO GAME GIANT ELECTRONIC Arts Inc. had a very simple formula for success: base a product on a popular sports or movie franchise, spend a fortune marketing it, and then push out a new version of that game year after year. The strategy netted big bucks with games based on the Harry Potter, James Bond, and Lord of the Rings movies, as well as with EA'S *Madden NFL* series. It also delighted investors with a reliable stream of revenue in the notoriously hit-or-miss video game business. In 2005, the company landed the No. 34 spot on the BusinessWeek 50 list of top corporate performers.

But now EA is stumbling, and a big part of its time-tested strategy is about to change. The company hopes that its next mega-franchise will revolve not around a football star, a boy wizard, or a dashing British spy, but...a microbe. The game is called *Spore*. Developed by Will Wright, the creator of *SimCity* and *The Sims*, it lets players design an invertebrate in its primordial stages and then guide its evolution until the creature's spring develop i thriving civiliza with cities, reli and spaceships. ambitious goal create more innovative, inter developed ga while lessening company's dep ence on pr sional sports Hollywood m franchises.

SLUGGISH SAL

THE PLAN is no if not challen It's forcing EA's ident of World Studios, Paul L rethink the wa company c games and to f out a way to t form a risk-aver ganization k for its operation ficiency into a h of creativity. Le little choice. Movie studios and s leagues are driving the costs of lic higher, while video game sales stayed sluggish. Making matters v EA flubbed its debut on Microsoft' Xbox 360 console, failing to grab it al No. 1 market share and losing smaller competitor Activision In though the company's revenues, a mated $3.3 billion to $3.4 billion f fiscal year ending on Mar. 31, r more than twice the size of its largest U.S. competitor, it has eithe ered or missed its earnings guidan the past six quarters. The reaso clude delayed games, higher-th pected development costs, and pointing sales of key titles.

To reverse the slide, Lee needs t home team to hit a few home ru wants to push the number of based on internally c concepts above 50% of E tal portfolio in the next 1 months, from about 3 day, and create at lea new franchise a yea company is aggressively ping up marquee talent ing from award-winning game de Doug Church to movie director Spielberg, who will consult on th lines of three original games. It

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building a brand-new development studio in Montreal that will focus entirely on cooking up new, original titles. With some $3 billion in cash and zero debt, EA is also eager to acquire independent studios.

At the heart of the Redwood City (Calif.) company's mission is figuring out how to inject creativity into its 6,100-employee operation without losing control. Most development houses typically rely on tightly knit groups of 40 or so programmers, artists, and designers, who focus on one game from start to finish for 12 to 18 months. Many such studios are wholly owned by large game publishers but have tremendous autonomy. And these little outfits have created some of the most imaginative and best-selling games today, from the *Grand Theft Auto* series, which came out of Take-Two Interactive Software Inc. subsidiary Rockstar North, to *Halo*, which was created by Microsoft Corp.-owned studio Bungie. Studios in this model "create an environment where creative control goes without question, and the voices around the table are all supporting the same vision," says John Riccitiello, a former president and chief operating officer of EA. "That doesn't happen everywhere in the game world." Riccitiello left EA in 2004 to join Elevation Partners, a private equity firm that has acquired two independent game studios (and boasts U2's Bono as a lead investor).

CREATIVE CONCEPTS EA is excited about original new offerings *Medal of Honor: Airborne* (top) and *Spore*

CROSS-POLLINATION

EA'S MODEL, WITH A FEW exceptions like Wright's *Spore* group, traditionally has been very different. It employs hundreds of developers at its main studios in Vancouver, Los Angeles, and Redwood City, and assigns them to projects as needed, sometimes rotating them through a number of different ones to meet a tough deadline. This lets the company release many more titles a year and gives it an unparalleled ability to release titles on time. And the millions that EA spends on market research to decide what games it should sell lessens the chance of a big bomb.

For much of EA's past, that setup made it a model of reliability. But it's hardly a recipe that stokes creativity. So Neil Young, general manager of EA's Los Angeles studio, has been working on a way to encourage innovation while boosting the staff's morale and competitive spirit. For the upcoming World War II game *Medal of Honor: Airborne*, for example, Young has broken the development staff into small six-to-eight person "cells" and assigned each cell a small mission for the game, from programming the way enemies weapons or flee to making the hu faces of the characters look as real as possible.

The idea is to embed technologica vances in every detail of the g "What I'm trying to build is a stud gamemakers," says Young. "I want people focused on building 90th tree or the 70th truck" game. Every week, the te with the most remarkable br throughs have their work tured on the flat-panel TV scr that are placed throughout the dio. "It creates the feeling tha are swimming in a sea of sma ventions," says Young, and l spur cross-pollination betwee ferent cells. The more tedious production tasks, such as colori trees or trucks, are outsourced cell system is now at work in seve the company's smaller studios, incl the new Montreal location.

Another change is that homeg projects will be given more flexible lines. Since these projects won't have release dates like sports or movie Lee believes it makes more sense to o op them until the team feels its idea ly realized. "In the past we have co ted to ship dates with large develop teams before we had a game design," Lee. "That is changing.... We're goi have the best games and release when they are ready."

That could mean a higher lev quality for the company's new ga tles, but it could also translate headaches for investors as EA's pr pipeline and revenue stream becom of a sure thing. That is probabl music to Wall Street's ears. But i just be the price EA pays to ac greater creativity.

PLAYBOOK: BEST-PRACTICE IDEAS

The Innovation Game

Electronic Arts wants to become less of a factory and more of a creative cauldron. Here's the plan:

HIRE HEAVY HITTERS

EA is snapping up visionary marquee names and companies and granting them autonomy. New talent ranges from award-winning game designer Doug Church to director Steven Spielberg, who will be a creative lead on three upcoming projects.

PURSUE HOME-GROWN IDEAS

By encouraging in-house talent to develop their own ideas rather than build games around existing franchises, EA hopes original titles will make up 50% of output over the next 12 to 18 months. That will cut the licensing fees it pays to movie studios.

MAKE BABY BREAKTHROUGHS

In the Los Angeles studio, small teams focus on isolated elements of a game, competing to create the most groundbreaking new feature. That gives them more of an ownership feel for a project and stirs competitive juices.

DON'T RUSH CREATIVITY

Developers will have a more flexible schedule to refine out-of-the-box ideas That's a big departu from the strict timetable that the company keeps for established franchis like *Need for Speed* and *Madden NFL*.

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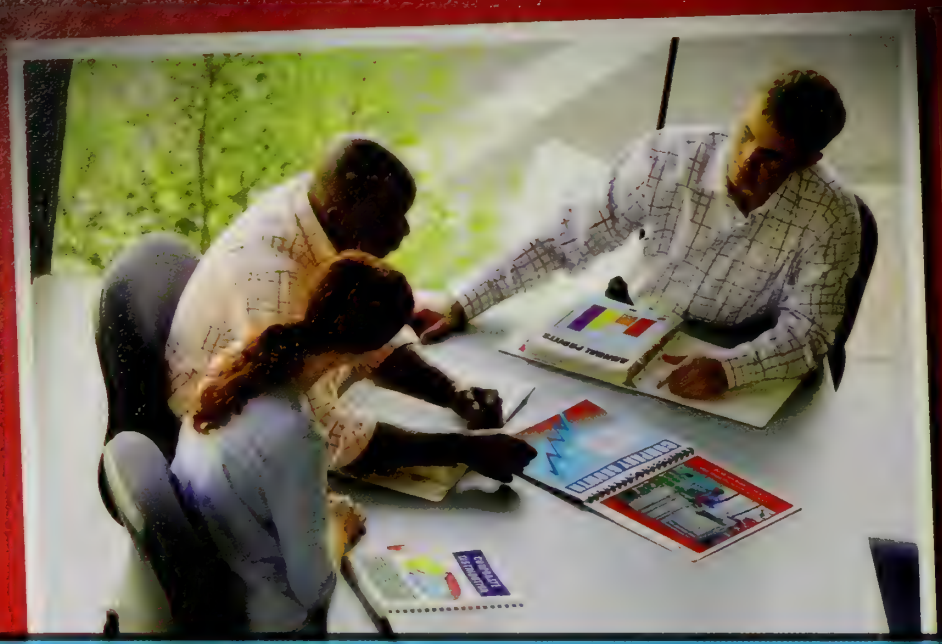

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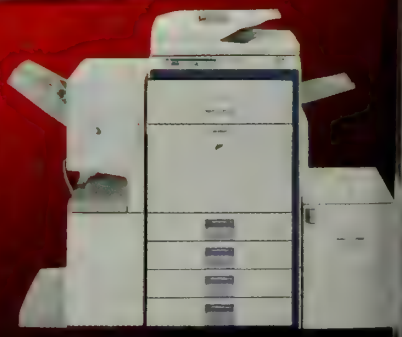

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low to Plug the $13 Billion Leak

entity theft is the fastest owing crime in the United States, it neither you nor your company eds to join the list of victims.

Have you invested more in data security than Bank of America? Is your security tighter than Ameritrade's? Are you less vulnerable Time Warner? Do you feel luckier Lexis-Nexis—or Wachovia, Comce Bancorp, Polo Ralph Lauren, PNC ncial Services Group and DSW Warehouse?

u'd better hope so. Because every of those organizations was a recent n of security breaches in which ination about large numbers of cusrs or employees was lost or stolen. ntity theft is America's fastest growrime, according to the U.S. Federal Commission. Some 10 million U.S. s were victims in 2005, with almost billion in losses, according to IT research and analysis firm Gartner.

For businesses, the consequences can be chilling: high recovery costs, lost revenues, damaged reputation, eroded consumer and investor trust. "Enterprises bear the brunt of the financial losses"—about $13 billion of last year's $15 billion, says Avivah Litan, vice president and research director at Gartner. "And our research shows that both online shoppers and online banking customers are more reluctant to conduct business electronically because of identity theft."

What's needed, then, is a coherent strategy for fighting identity theft and its effects. By understanding the evolving threats, as well as the emerging tools and techniques to counteract them, business leaders and consumers can go a long way toward mitigating the risks of this insidious crime.

From Crime to Crimeware

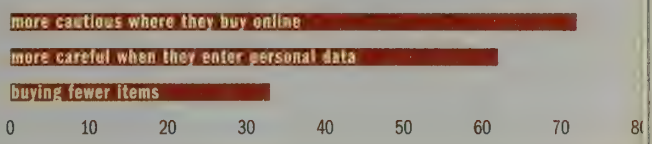
Identity theft comes in many guises—from dumpster diving by low-tech burglars to keystroke logging by high-tech crime rings. A particularly pernicious form is phishing, in which e-mails that appear to come from legitimate businesses invite users to give up personal data such as passwords and account numbers. Some 1.2 million Americans lost $930 million to phishing between May 2004 and May 2005, according to Gartner.

In addition, more than 80 percent of online consumers say they're less likely to trust e-mail from any company because of phishing. That has serious implications for companies that want to

aking a Toll on Consumer Confidence

ntity theft is making consumers alter their online shopping behavior, ording to a May 2005 study of 5,000 U.S. adults who are online. describing their attitude about buying online)

rce: Gartner



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reach customers by e-mail.

Even more threatening is the growing incidence of malicious software secretly planted on PCs. "Until recently, the worst attacks were from phishing," says Peter Cassidy, secretary general of the Anti-Phishing Working Group. "Now we're seeing the rise of crimeware, which is much more serious, because it's automated."

Such "malware" can capture usernames, passwords and account numbers. It can also search PCs for confidential information—including corporate data—and transmit it to a criminal server.

What's more, each identity crime is no longer a small-ticket affair. "We're seeing full-bore identity theft in which a criminal uses your identity to establish new lines of credit or even take out a mortgage," Cassidy says.

The good news is that security providers are offering a growing range of identity-focused products and services:

Security utilities: Includes traditional protections such as antivirus, antispam and firewall software. "Three years ago, 30 percent of viruses were designed to steal personal data," notes Vincent Weafer, senior director of Security Response at Symantec Corp., a provider of security products. "Today, it's 80 percent."

Good antivirus and antispam software can protect against up to 98 percent of attacks. But it's important to have all the bases covered with a comprehensive suite of products. "You can have the best antivirus software, but if you don't have a spam filter, you're still exposed," Weafer says.

Strong authentication: Identifies an individual by using two of three factors: something known such as a password, something possessed such as an ATM card, and something uniquely identifying such as a fingerprint.

Typically this is a matter of augmenting a password with a one-time-use scratch card, say, or a challenge/response approach in which a service rep asks a question that only the real customer can answer.

Encryption: Translates data into a secret code that's nearly impossible to decipher. Data can be encrypted inside a database or as it's transmitted over a network.

Biometrics: Uses a physical attribute—fingerprint, iris pattern, facial shape—to identify individuals. Laptops major vendors such as IBM, Hev Packard and Toshiba now come wit gerprint readers.

Identity federation: Provides acc multiple systems across departm

Signature Advice for Protection Against Check Washing

An increasingly alarming epidemic of a crime called "check washing" is giving rise to consumers and federal authorities nationwide. Some $815 million is lost each year in the United States to this kind of fraud.

To help fight the crime, uni-ball® teamed up with Frank Abagnale, one of the most respected experts on identity theft and subject of the blockbuster movie "Catch Me If You Can." Together, they spread the word about how individuals can help protect themselves–it may be as simple as the pen you use.

Highly recommended by Abagnale for securing your signature, the uni-ball 207™ gel pen has ink that contains color pigments which are absorbed and "trapped" into paper fibers making check washing nearly impossible.

For more information and tips from Abagnale visit this Web site: http://uniball-na.com

For Identity Protection, Press Copy

New forms of identity theft seem to proliferat like copies on a photocopier. But perhaps nc is more surprising than a modus operandi th involves copiers themselves.

Most organizations lease copiers from an off equipment dealer. When the copier comes o lease, the dealer typically re-leases it or sells to a third party. "Now, criminals are buying t off-lease copiers," reports Mike Marusic, vice president of marketing for Sharp Document Solutions. "They read the data from the harc drive and sell the rest for parts."

In possession of a digital copier's hard drive, these data thieves can access the informatio contains–customer data, trade secrets and r "Copiers contain a company's most pertinent up-to-date information," Marusic points out.

Sharp offers features that protect copiers ar printers against unauthorized use, automati encrypt and overwrite stored data, and restr network connections only to authorized com ers. "A growing percentage of our sales volu from customers who want to protect the dat their copiers," Marusic says.

To learn more about how Sharp technology reduce the threat of identity theft, visit this site for short and insightful white papers an other vital information:
http://www.sharpusa.com/security

Preventing Identity Theft: 5 Consumer Tips

Identity theft has no silver-bullet solution. Prevention requires a multipronged approach. Here are five ways your customers and employees can protect themselves.

1 Don't carry your Social Security number with you, and don't give out your Social Security number except for tax, employment or credit purposes.

2 Delete any e-mail that asks for personal data or invites you to log into an account. If you think the e-mail is legitimate, call the company or access your account from outside the e-mail.

3 Provide your credit-card number only on secure Web pages, indicated by a closed padlock in the bottom right corner of your Web browser.

4 Use passwords that are at least six characters, use upper- and lowercase letters, combine letters and numbers, and don't contain your name or words that are in a dictionary. Don't use the same password for multiple accounts, and change your passwords every six months.

5 Get free access to one of your three credit reports eve four months at 877-322-8228 or http://www.annua creditreport.com.

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The uni-ball 207 is the only pen endorsed by Frank W. Abagnale, a world-renowned identity theft expert and subject of the movie *Catch Me If You Can.*

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and company boundaries. Users have a single secure identity that can be used once to access multiple services—logging in to a secure airline site, say, and then moving on to secure hotel and auto-rental sites without having to log in again.

Transaction anomaly detection: Uses rules-based software to monitor accounts and flag unusual activity—large funds transfers or repeated attempts to access an account, for example. The approach can work across multiple channels such as phone, ATM and Internet.

Do What Works

Sometimes simple approaches are the best protection. A good example is uni-ball pens, some of which are specially designed to prevent a common form of check fraud. "Check washing" is a process in which fraudsters use common household products to erase ink from stolen checks and then make the checks payable to themselves. Losses from this type of fraud top $800 million a year in the United States, according to uni-ball.

Specially designed uni-ball pens use inks that are absorbed into a check's paper fibers and can thwart check washing. "Customer response has been overwhelmingly positive," says Doug Kruep, senior brand manager for uni-ball. "This is a simple, inexpensive and effective way for consumers to protect themselves."

Another common threat appears in the form of multifunction devices that combine printers, copiers and fax machines. Many users are unaware that digital printers and copiers store data on disk drives, just like PCs. Even if the data is deleted, it remains accessible on the disk until it's overwritten by new data.

"One of the best times to steal identities is around April 15, when employees are using the company copier to copy their tax returns," says Mike Marusic, vice president of marketing for Sharp Document Solutions. "Organizations invest in security to protect against outside intruders, but most identity theft occurs within the enterprise."

Fortunately, manufacturers of multifunction devices are taking steps to secure their products. Sharp, for instance, offers features that protect devices against unauthorized use, automatically encrypt and overwrite stored data, and restrict network connections to only authorized computers.

Beyond Technology

Like all data security, identity protection comes down to risk management—a balance between the need to protect data and the cost of doing so. Smart organizations have a comprehensive security policy and plan, an important component of which is identity protection.

Accountability for such a policy begins at the top. Consider designating a chief risk officer "with the ultimate responsibility for maintaining confidentiality of the data" along with "the requisite authority to carry out what is necessary to achieve this," recommends Jonathan Penn, an analyst at Forrester Research.

A secure mindset must then extend throughout your organization. Human behavior is the most important aspect of identity theft. Employees must learn which company and personal data is confidential and which programs are acceptable for download.

Finally, invest in consumer-awareness campaigns, which Gartner's Litan "one of the most effective tools fc tling identity crimes." After all, p discovery and reporting of identit can dramatically reduce monetary from fraud. ■

Identity Theft Resources

To see an electronic version of this section ready for e-mailing to colleagues as well as links to analyst and association reports, case studies and other valuable information, please go to http://www.businessweek.com/adsections and click on the headline "How to Plug the $13 Billion Leak."

In addition, the Web site has hot links to the following organizations:

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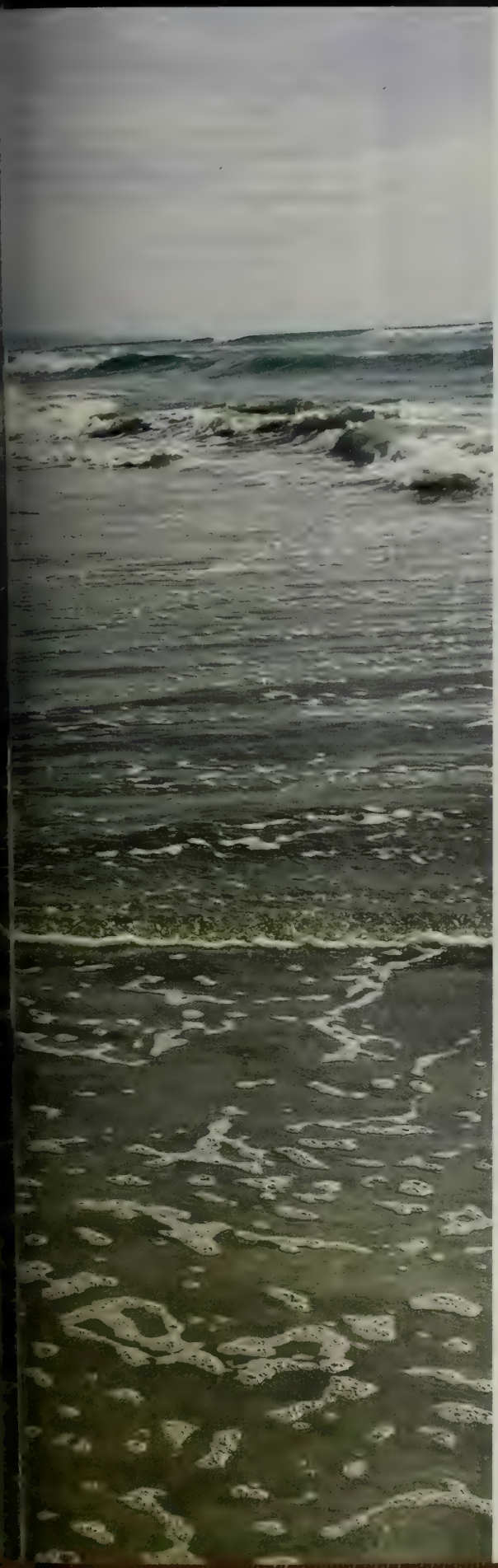
ENDLESS SUMMER Dr. Ron Rothenberg (left) is 60. His patient Howard Benedict is 61. They're thriving on vitamins, testosterone, and other hormones.



SELLING THE PROMISE OF YOUTH

THE ANTI-AGING INDUSTRY IS OFFERING A DIZZYING ARRAY OF HORMONES AND SUPPLEMENTS. BUSINESS IS BOOMING. BUT SOME REMEDIES ARE RISKY, AND THE BENEFITS ARE UNPROVEN.

BY ARLENE WEINTRAUB

As Dr. Ron Rothenberg bursts through the door of his anti-aging institute in Southern California, a cell phone pressed to his ear, his nurse warns him of the busy day ahead. There will be four-hour consultations with each of three prospective patients, she says. They're all coming to hear the 60-year-old Rothenberg's pitch about how his tailored regimens of diet, exercise, and hormones will make them feel younger and live longer.

In between the meet-and-greets, Rothenberg catches up with patient Dr. Howard Benedict, a retired dentist. The two men met in 1999 and became friends while surfing at Cabo San Lucas, Mexico. Rothenberg put Benedict on a $10,000-a-year regimen of 30 vitamins and supplements, plus testosterone

STEVE LABADESSA

'AN EMPOWERED WOMAN' Dancer Suzi Tillman, 51, takes 15 supplements a day, rubs estrogen cream into her skin, and feels like her young self again

gel and injections of human growth hormone. Benedict says his arthritis pain has eased so much that he rides his bike and surfs for hours at a stretch, after sucking down a huge protein smoothie he learned to make from Rothenberg's in-house nutritionist. "Those other guys my age, they're only out there surfing for a half-hour," says Benedict, 61. As a sly smile creeps across his face, he adds: "I feel like I'm 20 years old with my wife. It's just amazing."

For Rothenberg, this is a typical day at the California Healthspan Institute in Encinitas, which caters to patients eager to slow down the inevitable march toward Metamucil mornings and Viagra nights. As 77 million baby boomers approach retirement, the relatively new field of anti-aging is racing to keep up with them. Anti-aging medicine goes way beyond Botox, Retin-A face creams, and medical spas that offer plastic surgery and laser-based cosmetic procedures. In fact, only a small portion of what these new medicine men and women do is aimed at making patients younger. Instead, anti-aging doctors se turn back the internal hands of time by scribing megadoses of supplements that believe prevent the body's organs from de rating and dying. In addition to hotly dis biologic drugs such as human growth hor (HGH), there's an alphabet soup of su ments that includes DHEA, antioxidant mins C and E, glucosamine, Omega-3 more. Women have been consumers of mone replacement therapies for decades. men are also being primed to view middl in terms of male menopause, sometimes andropause. That's one reason more pa than ever are starting to gobble up the an ing promise.

Controversies

THE MOVEMENT EVEN HAS its own p sional group: the American Academy of Aging Medicine (A4M), which issues a c cation to doctors who want to hang shingle in this field. A4M sponsors confer sells books and DVDs about anti-aging serves as a general clearinghouse of inf tion for patients looking for the nearest cli also waves around research showing th industry pulls in $56 billion a year now that number could swell to $79 billion by The promise A4M and its members dang fore patients is summed up perfectly in th of Rothenberg's self-published book: *F Ageless*. According to A4M, 1,500 doctor sought board certification in anti-aging cine since 1996. Rothenberg, who has 300 patients, was No. 10 on the list, an proud of his status as a pioneer. "We're r ing the aging process and improving qua life," he says. "I see it every day."

Rothenberg and other practitioners field have precious little scientific data t up their claims that the p extend life. But they insist th imens will guarantee Rothenberg calls "rec larization"—years of h living followed by a short, ac cline, as opposed to a slower, gle-like descent toward the grave. As Rothenberg p "Rather than spending a few years in a nursing home, w fall apart fast and die?"

The anti-aging movement is barely one step ahead controversies it has spawned. Many of the dietary supple these physicians recommend are not regulated as medic by the Food & Drug Administration. That means the pr don't go through the rigorous safety and efficacy testi most prescription drugs face. Furthermore, some ho products prescribed by anti-aging physicians are made cialized pharmacists who, detractors say, may not be ad to the same FDA standards of consistency and purity as market drug manufacturers. The anti-aging arsenal coul

antially in coming years as a whole com-
ent of experimental biotech drugs comes
ream (page 72).

any critics are crying for the FDA to crack
n on the anti-aging industry, especially on
enegades who illegally hawk their wares all
he Net. The claims of the promoters range
n the extreme fringe to the downright ille-
says Dr. Thomas Perls, associate professor
dicine and geriatrics at Boston University,
has been such an outspoken opponent of
nti-aging industry that A4M sued him and
ier professor in 2004 for defamation.

ROTHENBERG'S TRADE-OFF: YOU GET MORE YEARS OF HEALTH—AND THEN "FALL APART FAST"

H is by far the most controversial weapon in the anti-ag-
senal. A substance produced in the body, it was synthe-
by several biotech companies in the early 1980s. The first
icts were approved by the FDA in 1985 to help short chil-
grow taller. Lately the anti-aging industry has latched on
H as a tool for boosting immunity, memory, heart func-
muscle mass, and more. (An upcoming book, *Game of*
ws by Mark Fainaru-Wada and Lance Williams, has cre-
stir by alleging that baseball slugger Barry Bonds took
among other performance enhancers.)

henberg, who has taken growth hormone himself, be-
it could help people live to be 125. But it's illegal for any-
distribute HGH for anti-aging purposes, and critics be-
many players in the anti-aging industry who prescribe it
olating laws and endangering patients in the process. The
ndustry formally opposes the efforts to link HGH with
ging, but behind the scenes, companies may not have
much to douse the enthusiasm: In December a federal court unsealed a whistleblower suit against a unit of Pfizer Inc., accusing the drug giant of promoting HGH for anti-aging use (page 70).

Then there are concerns that anti-aging promotions may be more like scams. Because aging is not actually a disease, very little of the expense is covered by insurance. That leaves patients paying often substantial fees out of pocket. Rothenberg's complete health assessment—a two-day process that includes meetings with a nutritionist and an exercise physiologist—costs $2,500 or more. The patient often walks away with a long shopping list of diet supplements and natural hormones that can run $250 a month. And HGH can set patients back by as much as $2,000 a month. "Buyer beware: These anti-aging clinics are marketing themselves as one-stop shops for getting tuned up after 60," says Daniel Perry, president of the Alliance for Aging Research, a skeptical Washington (D.C.) group that advocates for the study of aging. "But people are spending a lot of money to get treatments that may not be medically necessary."

Rothenberg points to himself as proof that anti-aging medicine works. A former hippie, he earned an M.D. at Columbia University. He practiced tropical emergency medicine in the Amazon, then returned to the U.S. and taught seminars on the subject at the University of California at San Diego, where he is still on the faculty. (He was also the local rattlesnake expert.) He first started injecting himself with HGH about a decade ago. Having just passed his 50th birthday, he felt off his game—tired, disengaged with his patients at his San Diego practice, and less lively on his surfboard. "I was losing my edge," says

CEANS OF POTIONS

i-aging doctors often prescribe vast quantities of alternative treatments to halt the cruel march me. Critics are concerned about many of the things these physicians promote, including:

TMENT	ANTI-AGING DOCS SAY	CRITICS SAY
MAN GROWTH RMONE	This biotech drug—most often prescribed to help short kids grow—improves memory, mood, body composition, cardiac function, and more in adults.	It can cause high blood pressure and odd structural abnormalities in the hands and feet. And it may cause previously undetected tumors to grow.
TURAL ROGEN AND OGESTERONE	These plant-derived hormones protect against heart disease, osteoporosis, and Alzheimer's, and they relieve menopause symptoms without the risks associated with Premarin and other synthetic hormones.	Many of these hormones are made by pharmacies that are not monitored closely enough by the Food & Drug Administration, so the products are not proven to be either safe or effective.
EA	It's the super-hormone, improving libido, muscle mass, memory, mood, and immunity, while lessening the risk of diabetes, cancer, and hardening of the arteries.	By the time DHEA pills are digested, very little of the hormone actually ends up in the bloodstream. Show us more data proving it works.
ROID RMONES	The body produces less of this hormone as we age. Fighting that decline works wonders on energy, stamina, libido, mental vigor, and mood.	Don't mess with the thyroid gland. Too much of this hormone can cause heart arrhythmias and bone loss. And some doctors' tests are unreliable.
TOSTERONE	It counteracts male and female menopause, benefiting heart health, bone mass, and memory, and it makes Viagra passé.	Male menopause? No such thing. And too much can cause hair loss and mood problems in men, and male traits in women.
LATION RAPY	This chemical treatment, given intravenously, clears the body of excess metals such as iron, lead, and aluminum, in the process slowing heart disease.	Beware. This process has not been proved to benefit heart health. And it hurts the pocketbook, costing as much as $2,400 for a three-month regimen.

Rothenberg, who, with his rapid-fire speech and easy laugh, bears more than a passing resemblance to the comic actor Gene Wilder. "I was losing my memory. Libido-wise, it was take it or leave it." Today, with a regimen that includes supplements and testosterone, he has enough energy to run his practice, train other anti-aging physicians, and even work once a week as an emergency room doctor.

At 8:30 a.m. on a crisp February day, Rothenberg takes the stage at a seaside Holiday Inn in San Diego, eager to share his knowledge with fledgling anti-aging physicians. He's the moderator of a conference sponsored by San Diego's University Compounding Pharmacy (UCP), which enjoys a booming business selling anti-aging treatments. Rothenberg asks how many of the 166 people in the audience are attending their first anti-aging seminar. Hands shoot up all over the room. His enthusiasm rises. "Aging is a disease that can be prevented or reversed," he booms to the newbies. "We are not prisoners of our destiny." Later, he dashes across the conference room, with the microphone in his hand, fielding questions for presenter Dr. Pamela W. Smith, who has started up 27 anti-aging clinics in cities such as Chicago, Detroit, and Houston. Admiring Rothenberg's boundless energy, she quips: "That's the growth hormone!"

MASSIVE ASSAULT Some anti-aging enthusiasts take as many as 30 vitamins and supplements a day, a regimen that can cost $10,000 a year

Cancer Risk?

ROTHENBERG HIMSELF treats growth hormone with gravitas. That's because federal laws, inspired by sports-doping scandals in the late 1980s, bar doctors from prescribing HGH for uses not approved by the FDA. One disease in adults that does qualify is adult growth hormone deficiency, which Rothenberg believes many of his patients, including Howard Benedict, have. The disease carries symptoms such as depression and increased body fat. Blood tests can confirm the deficiency, but they're not always reliable, Rothenberg says.

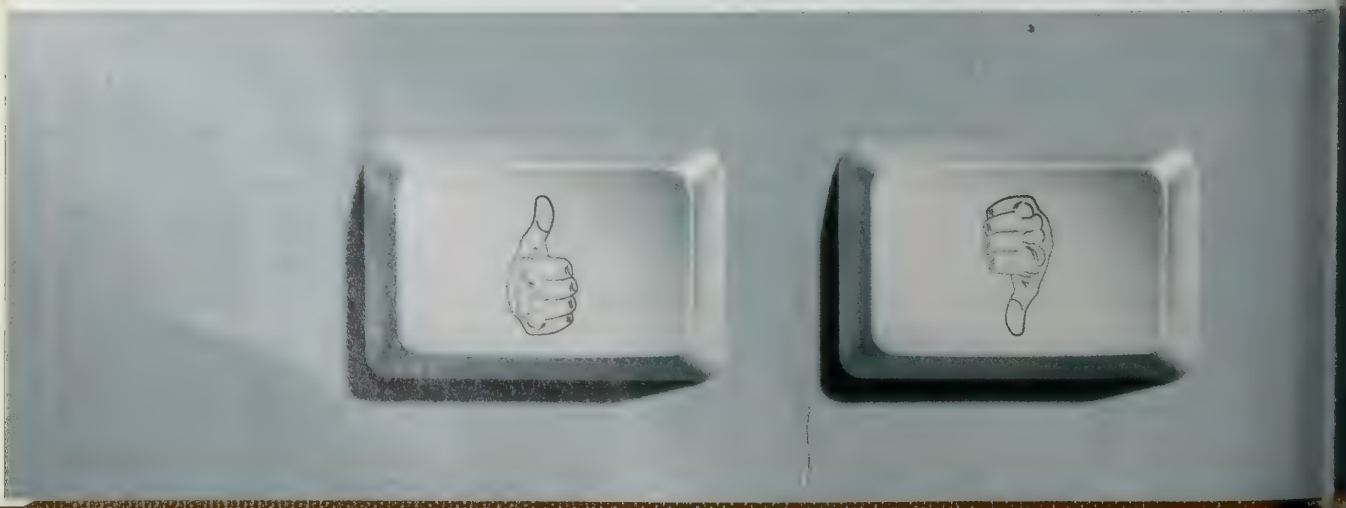
At the conference, Rothenberg explains to doctors that it's O.K. to diagnose the disea symptoms alone, as lon physicians document the di sis as being adult growth mone deficiency, rather th condition HGH has not bee proved to treat, such as fa In response to concerns th much HGH can cause c Rothenberg flashes a refere a study carried out by en nologist Dr. Mary Lee Vanc others that he says shows t no cancer risk.

Hearing about this s Vance is incensed. She sa patients in the cited studies were just enough growth hormone to r severe deficiencies. And while they didn't increased rates of cancer, oth search has shown that HGH promote tumor growth. W more, the hormone can spark high blood pressure, blood and structural changes in the hands and feet, accordi Vance, professor of medicine for the University of Vi Health System. "They're misquoting [scientific] literat the wazoo," she gripes, referring to the anti-aging propo

Lately, the FDA has started to take notice of improper keting of HGH. The FDA's office of criminal investigation sued 55 HGH cases last year, which is more than four tim number it looked into in 2000. "The FDA believes that a cian who prescribes, dispenses, and/or administers HGH unauthorized use violates federal law," says agency s woman Laura Alvey in an e-mail. She points out example as the case of a Florida dentist who last year pleaded gu federal charges of illegally selling HGH over the Intern could face up to five years in prison for each of four count $1 million in fines.

Rothenberg believes that responsible anti-aging phys are simply restoring HGH in patients to its appropriate, ful levels. And the fact that there's no exact science to di ing adult growth hormone deficiency leaves them a lot way. Package inserts for products such as Genotropin, version of HGH, lay out guidelines for detecting the d but, says Rothenberg, "there's nothing in the law that sa to prescribe this. It's a gray area."

It's not just HGH that worries critics. Anti-aging docto



:ribe testosterone, often in skin gels, and they recommend ıormone DHEA, which can convert to estrogen and testos-ıe in the body. They say the treatments enhance heart :h, sexual performance, and memory in men, and fight ɔpause symptoms in women. Anti-aging doctors run a bat-ɔf blood and saliva tests prior to prescribing testosterone, say they're simply replacing what's missing. But slipups ıe costly: Too much testosterone can cause mood disorders ıair loss in men. In women, it can bring on acne, deepen-oices, and unwanted hair growth.

ıe hormones estrogen and progesterone have also given o controversy. FDA-sanctioned synthetic versions, such as h's Prempro and Premarin, got a bad rap in 2002, when a study by the Women's Health Initiative (WHI) suggested ɔrmones might increase the risk of breast cancer and heart se. At that point, many traditional gynecologists shied from prescribing hormones.

rough the Cracks

E RECENT STUDIES HAVE downplayed the heart disease ɔut in the meantime, anti-aging doctors have stepped in to : void, promoting natural, or "bio-identical," hormones as lternatives. Critics take issue with these products for sev-easons. First, bio-identical hormones are made by so- compounding pharmacists. Historically, they have been tted by law to customize medications for individual pa-—for example, people who react adversely to certain in-

e Pill Makes You Younger...

the Story on the Cover Story: For a podcast rview with Science Editor Arlene Weintraub xecutive Editor John A. Byrne, go to v.businessweek.com/search/podcasting.htm.

with a Longevity Guru: Dr. Ronald Klatz, who coined the "anti-aging," is now head of the American Academy of Anti-g Medicine, which has been under attack by academics and tional physicians.

-Aging Underground: For more on this story, h *BusinessWeek Weekend*. Check your local stings, or go to businessweekweekend.com to this and other segments from our weekly TV program.

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WHAT'S MISSING IS SCIENTIFIC EVIDENCE THAT THESE REGIMENS ACTUALLY SLOW DOWN OR REVERSE AGING. THAT PROOF MAY NEVER COME

gredients. But under FDA rules, they should not be manufacturing or selling drugs to a mass market. To get into that business, they would have to submit to strict supervision of their facilities, the quality of their products, the claims on their labels, and the like. Critics blast the FDA for letting too much activity slip through the cracks.

The second big complaint involves the very term "bio-identical." The hormones prescribed by anti-aging doctors are generally derived from plants such as soybeans and sweet potatoes, and combined into proprietary recipes, which may never be tested in human trials. Anti-aging proponents say the substances are natural, safe alternatives to FDA-approved hormones such as Premarin and Prempro, which are derived from the urine of pregnant horses. But many doctors are leery of the bio-identical pitch. "Yams do not make hormones like humans do," says Dr. Bruce Bouts, an internist in Findlay, Ohio. "Compounding pharmacies are selling a bill of goods."

In October, 2005, Wyeth weighed in on the debate by filing a petition to the FDA requesting that the agency regulate the compounding pharmacists with the same stringent standards it applies to pharmaceutical manufacturing companies. "We're concerned about what we believe is illegal mass-marketing," says Ginger Constantine, vice-president for women's health and bone-repair research at Wyeth. "They're saying their products are safer, but they haven't tested that." Federal regulators say that they're on the case. "The FDA is aware of the concerns raised about compounded bio-identical hormone products, and the agency is evaluating this issue," according to Steven Silverman of the office of compliance at the FDA's Center for Drug Evaluation & Research.

Many anti-aging advocates have an almost cult-like faith in the movement. John Grasela, who runs UCP with his brother, Joe, says he has been taking many of the supplements he sells for the past 10 years. "I'm in the best shape of my whole life," says Grasela, 57. Dr. Alvin Yee, a protégé of Rothenberg's who recently opened an anti-aging practice in Costa Mesa, Calif., says he designed an anti-aging regimen for himself, even

SHARE YOUR THOUGHTS.

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though he's only 36 years old. "I've gained eight to nine pounds of muscle," he says during a break at the UCP conference, where physicians were enthusiastically perusing the selection of powders, protein bars, and syringes lined up against a back wall. "My girlfriend noticed."

What's missing amid all this excitement, though, is any firm scientific proof that these regimens actually slow down or reverse the aging process. That proof may never come. A truly scientific study would have to span several decades and include a control group that's taking a placebo. Imagine how difficult it would be to persuade patients to participate in such a knowing that they could end up taking a sugar pill for 50 rather than the pill that might actually extend their "Where's the big double-blind study, placebo-controlle never going to happen," Rothenberg concedes. A handful year studies of hormone replacement are starting now, Ro berg says, but he's not willing to wait for the results. "Let' our best shot now."

One of the most important watchdogs in the practice of icine is conspicuously absent in the anti-aging industry. F

LEGAL TANGLE AT THE FOUNTAIN OF YOUTH

The drug human growth hormone (HGH), one of the most tightly regulated substances on the market, is proving to be a thorn in the side of Pfizer Inc. *BusinessWeek* has reviewed internal documents shedding new light on allegations that Pharmacia Corp., a company Pfizer acquired in 2003, improperly promoted its drug Genotropin to doctors who intended to use it as an anti-aging treatment. The Food & Drug Administration has approved Genotropin and other synthetic versions of human growth hormone to treat certain diseases. But it is illegal for manufacturers such as Pfizer to promote the hormone for anti-aging use, which is not approved by the FDA.

BusinessWeek was shown the documents by Dr. Peter Rost, a former Pharmacia executive, who filed a civil whistleblower suit against Pharmacia and Pfizer in U.S. district court in Massachusetts in 2003. The suit was unsealed in November, 2005, after the U.S. Justice Dept. declined to intervene. But Rost is continuing to pursue the suit with the help of private counsel.

Pfizer has filed a motion to dismiss, arguing that both Pharmacia and Pfizer had acknowledged that there were problems and had sought to address them. Separately, Pfizer's most recent 10K, filed on Feb. 28, says there are continuing Justice Dept. investigations into the marketing of Genotropin.

It isn't clear whether these investigations are related to the allegations in the whistleblower suit. But Rost says that after he filed the suit, he was interviewed by the Justice Dept., the FBI, and the FDA's Enforcement Div. He says he has testified twice as a grand jury witness in a criminal investigation being pursued by the office of the U.S. Attorney in Boston. A spokeswoman there declined to comment.

The legal tangles could have broad repercussions. The documents *BusinessWeek* examined suggest that Fred Hassan, former chief executive officer of Pharmacia, may have been aware of efforts in the company to encourage the improper promotion of Genotropin. Hassan is currently head of Schering-Plough Corp., which is not part of the investigations.

Hassan's troubles go back to January, 2000, when government concerns about the abuse of HGH were on the rise. A memorandum landed on Hassan's desk from Dr. William Abelove of the Renaissance Longevity Center in Florida. The letter opened by saying: "The Renaissance Longevity Center is initiating the most aggressive ethical campaign ever launched for the marketing of human growth hormone...." It went on to suggest a "strategic alliance" with Pharmacia. Handwritten notes at the top of the memo indicate that Hassan passed the letter on to members of his marketing staff with instructions to "follow up."

Rost alleges that the memo and other internal documents that are part of his case prove the companies knowingly marketed HGH to anti-aging doctors. By law, drug companies are forbidden to market any drug for so-called off-label use. Additional restrictions on HGH make it particularly sensitive. "This is an anti-aging doctor saying that he's going to put a lot of money behind promoting [Pharmacia's] formula," says Rost. "Hassan...should have known. It's very illegal."

Hassan left Pharmacia right when Pfizer acquired it in 2003. In response to a request for comment, Schering spokesman Stephen Galpin said: "Fred Hassan is prevented from commenting on this or any other issue pertaining to the former Pharmacia under a confidentiality agreement with Pfizer." But other executives who were close to Hassan say he did nothing improper. Goran Ando, who was vice-president for research under Hassan at Pharmacia—and who was hand-copied on the Abelove memo—warns against attaching too much significance to Hassan's instructions. "He passed along virtually every memo," says Ando, now a board member of several companies in Britain. As for associating anti-aging centers, Ando says, "We tried discourage it."

Documents reviewed by *BusinessWee* suggest that executives below Hassan pursued a relationship with Abelove, and were aware of the legal implications of do so. In February, Abelove sent a letter, cop to eight Pharmacia executives, describin

TRACKING THE ABUSE

Illegal use of human growth hormone is looming larger on the FDA's radar

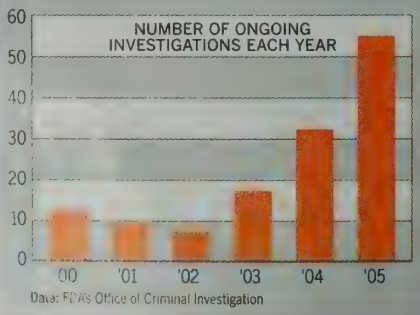

CHART BY ALBERTO MENA/BW

ers, by and large, have no supervisory role here. Most anti-; clinics and compounding pharmacists require their pa- ; to pay cash. The patients may be reimbursed later for services, such as standard blood tests, but the doctors selves are rarely filing the claims. So they're off the radar of nsurance companies, which have been trying of late to physicians of what they consider to be bad habits, such as ng unnecessary prescriptions for costly and potentially ful drugs. That means patients have one less entity look- ut for their safety—or at least their pocketbooks.

Some critics have taken it upon themselves to fill in as watchdogs. A paper published in the Oct. 26, 2005, issue of *The Journal of the American Medical Assn.* describes the distribution of human growth hormone for anti-aging as both rampant and illegal.

An estimated 30% of the growth hormone prescriptions in the U.S. are written for non-FDA-approved uses, according to the paper, co-written by Boston University's Perls and S. Jay Olshansky, professor of epidemiology at the University of Illinois at Chicago. "They say they're stopping or reversing aging, but

BILL CRAMER

WHISTLEBLOWER Rost alleges that his former employer Pharmacia improperly promoted Genotropin as an anti-aging treatment

t would be on the agenda at a meeting. ong other topics, Abelove wanted to uss "the ability for the Abelove Longevity ters to purchase growth hormone at ntity discounted prices."

oon afterward, Pharmacia received l advice on this matter from the law firm gan, Lewis & Bockius. The firm sent a idential memo to Pharmacia's orate counsel outlining the "regulatory legal implications of possible ngements with Renaissance Longevity Centers." The six-page memo, examined by *BusinessWeek*, lays out various legal risks inherent in providing the drug at a discount to Abelove's practice. It may be viewed, the memo says, "as an improper incentive that encourages physicians to overutilize the drug, which could be found to be a violation of the Medicare/Medicaid Anti-Kickback statute."

The lawyers had every reason to be fastidious. In 1999, Genentech Inc. pleaded guilty to a federal criminal charge that it improperly promoted its growth hormone. It paid a $50 million fine. The February, 2000, memo to Pharmacia from Morgan, Lewis & Bockius references the Genentech action in a section labeled "FDA Enforcement Risks." It advises that Pharmacia should reduce the risk by ensuring that doctors not receive "cash payments or free goods as a result of conducting any research studies." An assistant to Stephen Paul Mahinka, one of the lawyers who wrote the memo, said in a voice mail that Pfizer's policies prevent outside counsel from talking to reporters.

Documents show that in May, 2000, Abelove signed a consulting contract with Pharmacia to pursue a broad range of activities related to HGH, including reviewing marketing strategies, attending meetings on growth hormone, and educating Pharmacia employees about growth hormone. The contract included a promise of a $50,000 payment. It's unclear whether Abelove got a price break on Genotropin. Abelove, a practicing physician in Miami and Weston, Fla., with a strong interest in anti-aging treatments, declined to comment on the contract because of a confidentiality agreement he has with Pharmacia.

Pfizer and Pharmacia addressed Rost's allegations in the motion to dismiss the whistleblower lawsuit. Pfizer says Pharmacia took corrective actions in 2002, including terminating all discount contracts for Genotropin. The issues "were corrected by Pharmacia and later by Pfizer, and Pfizer voluntarily disclosed them to the government as soon as it was possible to do so," says Paul Fitzhenry, a spokesman for Pfizer. Abelove is not mentioned by name in Pfizer's court filings. Fitzhenry says, however, that "the Abelove contract was terminated before Pfizer acquired Pharmacia."

Rost, admittedly, has an ax to grind when it comes to both Pharmacia and Pfizer. Pfizer fired him late last year after the case was unsealed, prompting him to counter with a lawsuit charging wrongful termination. Rost has a history of battling the pharmaceutical industry. He once alleged tax violations on the part of international staffers at his former employer, Wyeth. And in 2004 he had a public war of words with Pfizer over drug reimportation. Rost's allegations about Genotropin extend far beyond what Pharmacia might have been planning with Abelove's Longevity Center. His whistleblower suit also alleges that Pharmacia used a research program as a vehicle to reward physicians for prescribing Genotropin and that the company improperly paid for anti-aging doctors to attend meetings held at chic resorts.

Pfizer says that these and other allegations were addressed in its motion to dismiss. As the drug giant and its former employee trade jabs, HGH used as an anti-aging treatment is certain to remain under the microscope.

what evidence do they have?" says Olshansky. "What evidence do they have that it's safe? Our job is to protect the public."

The anti-aging industry is fighting back. In 2004, A4M filed a lawsuit against Perls and Olshansky in an Illinois circuit court. The suit alleges that for years, the two professors have engaged in "defamatory conduct" and interfered with A4M's ability to do business. The suit blasts Olshansky, for example, for once granting A4M a "silver fleece" award—a designation meant to shame medical professionals who claim they have invented ways to reverse aging. The suit also alleges that at a 2004 A4M conference, Olshansky left a bottle of vegetable oil labeled "snake oil" for Drs. Ronald M. Goldman and Ronald M. Klatz, who head A4M.

The parties on both sides declined to comment specifically on the suit, which is still pending. Of Olshansky and Perls, says

THE BIGGER THE ANTI-AGING MOVEMENT GETS, THE MORE OPEN IT BECOMES TO TRULY OUT-THERE EXPERIMENTS

Klatz: "They're not scientists. Because of our success, t trying to make a name for themselves. They're on a appointed soapbox." As for Rothenberg, he doesn't let hi get distracted by the controversy. "Growth hormone is no than any drug that can be prescribed off-label," he says.

The public has little inkling about the expert bickering.

BIOTECH'S DIET IN A BOTTLE COULD EXTEND YOUR LIFE

If you cut a mouse's daily calorie intake by 30%, it will live at least 30% longer than its normal two-year life span. Some say this is because the body under stress produces protective substances. The trick works with worms and fruit flies, too, and would probably extend life in humans, scientists believe. But we'd all have to learn how to eat just enough to stay alive. This isn't about forgoing Girl Scout Cookies or three-course meals: A true anti-aging diet could be pure torture.

A handful of biotech companies are developing drugs that produce the effects of such "caloric restriction" in the body without depriving people of food. Anti-aging doctors would love to prescribe a medication that would extend their patients' life spans to 125 years—extrapolating from mice. But companies would have no avenue for seeking Food & Drug Administration approval for such a treatment. "It would be undoable," says Stephen J. Hoffman, an investor in anti-aging biotech Sirtris Pharmaceuticals in Cambridge, Mass., who also sits on its board.

That's because it would take a half-century and countless billions of dollars to prove that the drugs extend life in healthy people, he says. Instead, Sirtris and other startups plan to test their products in diseases common in older people, such as diabetes and obesity, where it's relatively easy to obtain data that the FDA can scrutinize.

Sirtris is focusing on genes that make enzymes called sirtuins, hence the company name. Scientists have found that by making sirtuins more active, they can mimic the

effects of caloric restriction. The company hopes to start testing pills containing sirtuin-enhancing chemicals on patients with diabetes, Huntington's disease, and other ailments as early as 2007.

Elixir Pharmaceuticals, also in Cambridge, hopes to reap the benefits of caloric restriction by turning off part of the fat-gathering mechanism. Specifically, the biotech is attacking ghrelin, a protein released in the stomach that makes us feel the urge to eat. A drug that prevents the body from using ghrelin may help patients lose weight, process sugar more effective and raise their ratio of muscle to fat.

Elixir cannot go to the FDA with an anti aging proposition any more than Sirtris ca So the company's more practical goal is t get its drugs approved to treat diabetes a obesity. Human trials could start within tw years. "We weren't out t discover the fountain of youth, though lots of people would like us to that," says Peter DiStefano, Elixir's chief scientific officer.

Regardless of what c eases the FDA approve these drugs to treat, th links between the world of biotech and anti-agin medicine are likely to b come more intimate. T biotech drug human growth hormone is alre a favorite tool of anti-ag doctors. Of the new tre ments, "90% will have plications to anti-aging medicine," predicts Dr. Ronald M. Klatz, presid of the American Acade of Anti-Aging Medicine. "They're not youth pills but they offer ways of i tervening in the specifi mechanisms of aging."

Venture capitalists are taking notice. Sirtris, founded in 2004, has raised $45 million in private funding so far. Six-year-Elixir has picked up $56 million. Both firr say they've detected some interest on th part of Big Pharma, although no deals ha been signed yet. The pioneers of this new science hate to be painted as the Ponce Leóns of the drug industry. For one thing, explorer never managed to find his preci fountain. Perhaps he was a few hundred years ahead of his time.

THE OOPS I JUST HIT "REPLY ALL" ERA IS OVER.

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aging centers are popping up all over the country, some with franchise-like models. Since 2003, Patrick Savage and his identical twin, Dr. Paul Savage, have opened seven branches of their anti-aging center, called BodyLogicMD.

It all started five years ago, when Paul decided to seek help from an anti-aging doctor. He wanted to slim down his 267-pound frame and get tips for lowering his stress level. After six months on growth hormone and DHEA, he had shed 87 pounds, gained muscle mass, and felt great. Then Paul, who lives in Chicago, went to visit Patrick in Boca Raton, Fla., for Christmas. The brothers hadn't seen each other in a number of years. "Patrick opened the door and said: 'Wow,'" Paul recalls. "His wife was like: 'Oh, wow. Oh, wow.'" Soon Patrick started on his own anti-aging regimen, and the two made a business of it. They hope to double the number of BodyLogicMD practices this year and increase their patient base by at least 300%.

YOUTH WILL BE SERVED Centers such as BodyLogicMD are popping up all over America. It currently has seven branches and aims to double that in a year

Some patients are aware that anti-aging is controversial, but they say they must answer to how they feel. Paul's patient Suzi Tillman first went to see him after a hysterectomy left her feeling that her entire body had simply shut down. "I wasn't sleeping, I couldn't think straight, I called my children the wrong names," says Tillman, 51, a former professional ballroom dancer who now teaches dance and works with senior citizens. "I felt ugly. For an empowered woman, this is scary." Now she is taking 15 supplements a day and rubbing a cream made of compounded estrogen into her skin. She feels like her old self. "Oh, the relief to have that cloud gone."

The bigger the anti-aging movement gets, the less caution it may be applying to experiments that are truly out-there. A handful of anti-aging doctors now offer a treatment called chelation therapy, which was once commonly used to treat lead poisoning. Chelation involves infusing a patient with chemicals that are believed to bind to metals and clear them out of the body. The process may reverse heart disease, proponents say. But it can cost as much as $2,400 and take up to three months. And its heart benefits have never been proven, critics say. The Web site quackwatch.org, run by Dr. Stephen Barrett, has posted multiple articles and studies t bunk the treatment. "There is n any evidence nor any logical reas believe it works," he says.

While Rothenberg isn't sure che therapy is a good fit for his practi admits that he's watching it closely. read the data," he says. "And if I bad angiogram, I'd explore chelation apy for myself before investing in sur

After a busy day meeting prosp patients, Rothenberg dines on sushi a flects on the anti-aging revolution. H he's open to changing how he practice nascent discipline, based on any res that sheds light on what works and doesn't. For example, he used to recom ginkgo biloba, an herb that is suppos boost brain power, but he rarely does s more. "The data hasn't supported it," he says. "I've g open mind." Meanwhile, he has brought other memb his family into the act. His 84-year-old mother, who te foreign languages, is n patient. And his 16-ye son has undergone hor testing, just to make sure the teen's testost levels are normal.

Rothenberg has tweaked his anti-aging regimen over the yea hasn't taken growth hormone in a while, but he still i himself with testosterone, as well as taking thyroid hor and an assortment of multivitamins. The surfboard pe on the wall over his desk, together with large framed p graphs of himself hanging ten, stand as testaments to hi search for eternal youth. He still surfs when he can, and escapes to his vacation home in Cabo, where he grov conut trees for fun. But the place he really likes to be is office, tailoring treatments to keep his patients youthf happy. "I'm like the personal family doctor from the No Rockwell era," he says.

By the end of the day, all of the visitors Rothenberg h for the first time have signed on to be his patients. ■

HOW YOUNG ARE YOU? ASK THE H-SCAN

A FIRST-PERSON ACCOUNT
BY ARLENE WEINTRAUB

I am speeding toward a birthday that I'm not looking forward to. A big one—the kind of birthday that gets lampooned in Hallmark cards of the sort that will soon start arriving from friends and family. So it was with great anticipation that I sat down in front of a machine called the H-Scan, which many anti-aging doctors say can determine a person's "real age" (the age described by the tissues of your body, not your driver's license).

The H-Scan uses software and various gizmos to assess 12 biomarkers of aging, including memory, eyesight, hearing, and lung capacity. I felt sure I would ace the test, and in the process garner much needed assurance that I'm really much younger than my numerical age.

After the hourlong test, the compute spat out what it thought was my real ag 45. My heart sank. I'm not 45. I can't possibly look 45. I hadn't felt so depres about a test since I got a fluke D on a hi school geometry midterm. With renewe sense of purpose, I waited for advice fr Dr. Ron Rothenberg of the California Healthspan Institute. I was counting on him to reverse the ravages of time....

BusinessWeek online For a full accour the reporter's day at the anti-aging clin go to www.businessweek.com/extras.

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Is the MBA Overrated?

Our surprising research suggests that few execs who hit the very top have the degree

BY LOUIS LAVELLE

IN THE EXECUTIVE PANTHEON, David K. Zweiner might be considered a minor god. An executive vice-president at Hartford Financial Services Group Inc., he joined the company in 1995, serving as chief financial officer, president of its property and casualty business, and director. As a graduate of No.1-ranked Kellogg School of Management at Northwestern University, Zweiner is one of 47,000 living alumni of one of the world's most prestigious MBA programs. But he has an unusual distinction: In 2004 his $3.7 million pay package made him one of only three Kellogg MBAs among the 500 highest-paid executives in the Standard & Poor's 100-stock index that year. "It opens that first door for you," Zweiner says of MBAs in general, and his in particular. "After that, it's up to you."

Zweiner's experience points to a little-realized fact about the MBA: It gets you so far. In fact, for those seek job at the very top of the corporate hi chy, it's not even a requirement. *Busi Week* research has found that fewer one out of three executives who those lofty heights do so with the he an MBA. And if you think a shee from a top school is a necessity, again. Only half of the executives MBAs went to the top 10 schools i 2004 *BusinessWee*k ranking.

The good news for MBA fans: If gr ates do end up on top, the investme time, effort, and lost wages will have worth it. In all, the MBA-toting h paid S&P 100 executives in our earned on average nearly $8.4 milli 2004, including salary, bonus, stock stock options, while those without th gree pulled in $7.1 million, amounti an MBA pay premium of about 19% much of that "value" appears to ste so much from the merits of indiv schools as from a complex interacti factors, including carefully cultivat school brands.

BusinessWeek examined the five hi paid executives at each of the companies in 2004, the most recen

WITH MBA
GE's Jeff Immelt, Harv Business School, 1982

for which data are available. We tracked their educational crede obtaining information on 441. F we calculated the pay for all 500 e tives and combined that data with tics about each school's alumni b well as company performance for 04. Given the incomplete nature of of the educational information, the ings aren't airtight but represent a r able correlation between educatio professional attainment.

Some startling numbers came to Only 146 of the 500 executives re having MBAs, a surprising numbe sidering the hundreds of thousand school alumni with enough expe

The Fortunate Few

Only a small percentage of alums of the top 10 B-schools are in the highest echelons of pay

2004 BUSINESSWEEK RANKING	1	2	3	4	
SCHOOL	NORTHWESTERN	CHICAGO	WHARTON	STANFORD	HA
NUMBER OF ALUMNI AMONG HIGHEST-PAID EXECUTIVES IN S&P 100*	3	6	10	11	
LIVING ALUMNI**	47,000	38,553	34,563	15,560	4
HIGHEST-PAID EXECUTIVE GROUP'S 2004 AVERAGE PAY*** (MILLIONS)	$6.7	$8	$7	$11	$

*Based on study of five highest-paid executives at each compa represents known executives with MBAs from each school **
***Includes salary, bonus, stock grants, and Black-Scholes val

alify them for top jobs. What's more, 71 received MBAs from the top 10 B-ols, and two-thirds of those execu- have degrees from just three institu-: Harvard Business School, Stanford ersity's Graduate School of Business, the University of Pennsylvania's rton School.

NG IS EVERYTHING

SIDERING THE hordes of living ni from each of the top 10 schools, the ber of grads who ended up in the sphere of pay seems remarkably . Only about one out of every 4,000 ni of top 10 MBA programs were ng the highest-paid executives in —the equivalent, in a class of 250 nts, of one lucky soul striking it rich 16 years. Since the alumni numbers le retirees, as well as new alumni who dequate experience for a top job, the l odds of being catapulted into the up-chelons are somewhat better. But little consolation to the alumni at Kel- for example, where one out of more 15,000 made it to the top, compared bout one out of 1,500 for Harvard. hear B-schools tell it, an MBA is the of admission to the ranks of sen-

HOUT MBA
t's Sam Palmisano le it nonetheless

anagers. While it may or may prove the odds of landing such it is not, strictly speaking, a re- ment. Timing plays a big role. of the MBAs in the study—includ- ch high-profile CEOs as General tic Co.'s Jeffrey R. Immelt, from HBS of 1982—graduated more than 20 go. Back then, B-school admissions etermined almost entirely on the ba- est scores, and many students lacked ple skills now recognized as critical nagerial success. So MBAs from that tion might be underrepresented in ecutive suite today. This was also before the B-school rankings. At he, MBAs—even those from highly respected schools like Harvard, Stanford, and Wharton—didn't have the marquee status they possess today.

Thus, many up-and-comers from that generation went without the MBA and did just fine. American Express, Citigroup, and IBM all have CEOs without MBAs. And those are far from the exception. Consider Frederick W. Smith of FedEx Corp. He got a BA from Yale in 1966, did a stint in the Marines, then came back and founded the express carrier, which he would expand into a $31 billion company over the next 35 years. Steven A. Ballmer dropped out of Stanford B-school to do the bookkeeping for a tiny startup that would grow into Microsoft Corp., where he is now CEO. And CEO H. Lee Scott Jr. of Wal-Mart Stores Inc. went on to a 25-year career at the retail behemoth after a BS in business at Pittsburg State University in Kansas.

Headhunters say that while an MBA may help land a first job after graduation, the career benefits from that moment on are almost nonexistent. "In the pure Darwinian world we live in, pedigrees mean nothing," says Peter D. Crist, chairman of Crist Associates, a Hinsdale (Ill.) executive search firm. "It's instinct, it's hard work, and it's raw intelligence."

In such a world, a credential that makes people better managers should confer an evolutionary advantage. But *BusinessWeek*'s research calls that premise into question. Examining company performance for 2002-04 shows that outfits run by CEOs with MBAs do, in fact, have modestly better return on equity than those run by non-MBAs. But median shareholder return for the MBA-run companies was significantly worse—7.4%, versus 9.9% for outfits run by non-MBAs. Researchers at Pace University came to similar conclusions but went a step further. They examined the 2000-02 performance of all companies listed on the New York Stock Exchange that were run by CEOs with U.S. undergraduate degrees and discovered that those with MBAs from top schools performed no better than those with less prestigious degrees. "If you go to Harvard, you're more likely to meet successful people who will enable you to do well," says Aron A. Gottesman, an associate finance professor at Pace. "You're not necessarily a better manager."

If MBAS aren't necessarily better at their jobs, what explains their pay premium? A big factor is the B-schools' carefully crafted brands. That's especially true for grads of top-ranked programs, who are frequently perceived by recruiters as the safe choices in a sea of maybes. Among the 71 alumni of top 10 schools who

6	7	8	9	10	
AN	CORNELL	COLUMBIA	MIT	DARTMOUTH	TOTAL
4	1	8	1	1	71
,79	10,336	34,073	8,845	7,738	260,432
4	NA	$8.3	NA	NA	$9

t, Capital IQ, Bloomberg Financial Markets, ZoomInfo.com.

landed in the high-paid group, Harvard and Stanford grads pulled in $10.9 million and $11 million, respectively. Those from Wharton and Chicago—which fared better in the 2004 B-school ranking—made less, with average compensation of $7 million and $8 million. When setting pay for new grads, recruiters consider school reputation to be more important than student quality, according to a new study. "The more prominent the school, the higher the salaries," says Violina P. Rindova, an associate professor of strategy at the University of Maryland who co-authored the research.

SELF-FULFILLING PROPHECY

THANKS IN PART to rankings, many top programs enjoy reputations, based on student satisfaction and other factors, that bear little relation to success in landing alumni at the pinnacle of corporate power. In fact, three of *BusinessWeek's* top 10 programs—Cornell, Dartmouth, and Massachusetts Institute of Technology—had just one alum each among the 500 highest-paid executives; Kellogg and the University of Michigan didn't do much better. The schools say their grads have reached the upper echelons of several companies that are not in the S&P 100. Kellogg cites CEOs Philip A. Marineau of Levi Strauss & Co. and Robert A. Eckerd of Mattel Inc. from the classes of 1970 and 1977 respectively. "We do have people strike it rich," says Karin Ash, director of Cornell's Career Management Center, "but in different ways."

At the very top of the B-school pyramid, a self-fulfilling prophecy appears to be at work. High rankings bring in scores of applicants, allowing the best programs the luxury of being highly selective. Stanford, for example, rejects nearly 9 out of every 10 applicants. The result: a concentrated pool of talented students who would likely succeed under any circumstances, including skipping B-school altogether. Says Jeffrey Pfeffer, professor of organizational behavior at Stanford and longtime critic of B-schools: "If you are good enough to get in, you obviously have enough talent and abilities to do well, regardless."

Maybe so, but for those who do opt for the B-school route in the hope that it will land them a top job, they shouldn't be surprised to learn that the degree, whatever its merits, is optional. In fact, the road to executive success that leads through B-school is, when it comes right down to it, the road less traveled. ■

MONSTER HIT Modernista!'s TV spots for Hummer clicked

A New Spark Plug for Cadillac

Brand-fixer Liz Vanzura aims to do for Caddy what she did for Hummer

BY DAVID KILEY

WHEN LIZ VANZURA took over global marketing for Cadillac in mid-January after a five-year stint running advertising for General Motors Corp.'s Hummer brand, she saw an immediate problem. The 60-second commercial created by agency Leo Burnett Worldwide Inc. for the Feb. 5 Super Bowl, an expensively produced surreal fashion show featuring the redesigned Cadillac Escalade on a runway emerging from a pool of liquid chrome, was a wreck. Fearing embarrassment at the game, held in Cadillac's hometown, and hearing the displeasure among GM's brass over the dull spot, Vanzura spent more than a week trying to re-edit the ad. But it wasn't salvageable—and scored near the bottom of consumer surveys on the game's ads.

To Vanzura, 41, the remedy was clear: Within weeks, she yanked half of lac's $300 million-plus ad busines Burnett, whose Detroit office has aged Cadillac advertising for mor 75 years. Then she hired Boston Modernista!, which has created Hu advertising with Vanzura since th tary brand's relaunch under GM in That shop will now make ads for lac's CTS, SRX, and all of Caddy's V performance cars, and it could snare the rest of the business with showing. Burnett had no comment

Stripping half an account fro agency and giving it to another m sound like a breakthrough idea auto maker reeling from losses a mored to be drifting toward bank But at GM, which spends more th billion a year on U.S. advertisin where some of its agency relatio go back to the days before televisi move signifies radical change. Th sive act by Vanzura, who has risin ence and is now on her second

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busts a company bureaucracy that has long relied more on the weight of its media budget than on compelling ad ideas to sell cars. In fact, GM is now adding smaller, less institutional agencies to compete for creative duties on its brands and new models. "TiVo and the remote control are killing us," says Vanzura. "We have to give consumers more reasons to listen to what we have to say."

That's a familiar refrain from any advertiser. But at GM, hidebound relationships between the carmaker and agency executives have often squelched attempts to shake up advertising. There's also a tendency to worry about offending red-state markets where GM is strongest. A Hummer ad created by Modernista that ran on the Super Bowl and the Academy Awards—and scored well with consumers and ad critics—depicts a giant robot and Godzilla-like monster falling in love and procreating the new Hummer H3 (the baby Hummer). Vanzura says one GM executive seriously questioned whether it would be better, in the name of moral rectitude, to have the mommy monster wear a wedding ring. Vanzura also stood up to objections from GM product boss Robert A. Lutz, who criticized an ad for the Hummer H2 in 2004 that showed a boy in a wooden soapbox-derby H2 instead of the real SUV. The ad won multiple awards, and Lutz later admitted he had been wrong.

MORE SHAKEUPS?

VANZURA IS EMERGING as the nearest thing GM has ever had to an internal creative director. Burnett, which also handles Pontiac ads, "had been on shaky ground for a couple of years," says one GM insider. But it took Vanzura to pull the trigger. And if she does for Caddy what she did at Hummer, and Volkswagen before that, she'll probably be moved to another brand or given a larger role where she can touch all GM products. Says sales and marketing chief Mark LaNeve: "She's going to shake things up around here.... There are no sacred cows anymore."

LaNeve made his bones at GM fixing the Cadillac brand when he greenlighted a campaign in 2001 featuring the music of rock band Led Zeppelin despite executive-suite worry that it might alienate Cadillac's white-shoe buyers. LaNeve has been gone from day-to-day management of the brand since 2004 and laments that the ads have "lost the edge." Still, though Cadillac sales were flat last year at 235,000 cars, it's in better shape than, say, Pontiac, Buick, or Saturn. Indeed, the comeback of Cadillac has been held up as a model for GM's other struggling divisions, so it can't afford to let its luxury brand slip before the others are fixed.

Other shakeups at GM are on the table. The auto maker recently gave New York-based maverick ad agency Deutsch Inc. a small piece of its Chevrolet business, an ad account held by Campbell-Ewald in Warren, Mich., since 1921. Deutsch also has developed a strategy for Pontiac, which is still handled, for now, by Leo Burnett. "The buzzword for advertisers now is 'roster,'" says Richard Kirshenbaum, co-chairman of New York agenc shenbaum Bond + ners LLC, whic among several age that work transient Coca-Cola Co. and T Corp. "Advertisers a creasingly roundin agencies and sho for the best work th get rather than lo themselves into agency," he says.

Like many big co nies, GM rotates sa nance, and even chasing managers ad and marketing and those neop have looked upon ad agency with de of service to GM welcome safety Vanzura represe new breed at GM LaNeve wants mo professional marketers confident e to take risks.

Vanzura's record goes back to th 1990s, when she was Volkswagen's rector, and Modernista CEO and cr chief Lance Jensen created a Boston's Arnold Worldwide Pa "Volkswagen ads during that tim creative standard for advertising i eral, not just auto advertising," says pendent marketing consultant I Keene. The use of indie rock mus storytelling created buzz aroun launch of the New Beetle and the brand. One memorable ad feature college-age slackers in a VW Golf c around and killing time to a Germa song that simply repeated the wor *Da Da*." They load an upholstere off the street into the hatchback, di that it smells bad, and deposit it b the curb.

Vanzura approved that off-b over the doubts of her bosses and fusal of most dealers to run it at a after parodies of it by David Lett and others surfaced, it achieved buzz and is talked about by VW fan ly a decade later. Vanzura's license risks and break the status quo refle sense of urgency around GM thes After all, brands that don't overh way they speak to the public may n be around 10 years from now. ■

The Vanzura Way

Cadillac's new marketing chief has a résumé that could help more than just one brand.

CADILLAC Liz Vanzura was named to head the unit in January, after two years of flat sales and advertising. She promptly pulled half the Caddy ad account from Leo Burnett and is working on a fresh positioning.

HUMMER Joined as ad director in 2001 and was granted part-time status so she could stay home with her young children. To soften its image, GM's consistently best ads play up adventure, tell sweet stories, and even poke fun at Hummer.

VOLKSWAGEN Managed advertising from 1995 to 2000. Ads featuring compelling people, indie rock music, and clever storytelling helped push VW sales nearly 400% in six years and became an industry standard for creativity.

BusinessWeek online To see VW and Hummer ads created under Liz Vanzu to www.businessweek.com/extras.

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Making It Work By Not Doing It All

Xerox R&D chief Vandebroek just focuses on what's important—at work and at home

BY NANETTE BYRNES

WHEN SOPHIE Vandebroek was appointed head of Xerox Corp.'s Canadian research and development operations in 1999, she didn't move to its headquarters in Mississauga, Ontario. Instead, for a year and a half she would get in her car Monday morning at her Penfield (N.Y.) home, drive the 2 hours and 42 minutes it took to get there, and work until 11:00 at night. After a quesadilla dinner and a night's rest at the nearby Holiday Inn, she would work until 4 on Tuesday afternoon, then head home. Wednesdays were spent in Xerox research facilities in Webster, N.Y., near her home. Thursday and Friday was another round trip to Mississauga.

This was no one-time exercise in extreme commuting for Vandebroek, who has lived in the same home for the past 14 years. She has traveled by plane to jobs in Stamford and Hartford, Conn. When she was pregnant with her second child, she worked seven hours away, living in an apartment during the week while her toddler daughter, Elena, was home with her husband, Bart, an engineer.

But Vandebroek would be the first to disabuse anyone of the idea that she's a kind of superwoman. To some c she's simply done what she had to c years ago her husband died of a asthma attack while they were ca in the Adirondack Mountains, l Vandebroek to raise their three cl an ocean away from family in E Since then, she's made her life wo by trying to do it all, but by focus what's most important.

NOT JUST CO Vandebroek looking at nc technologies

An ability to prioritize is part Vandebroek, 44, is such a success ecutive. On Jan. 1 the 14-year Xero an became chief technology office seeing its 600 researchers and en and directing the $760 million p copier maker spends each year o "Sophie is one in a million on a l skill, knowledge, and intellect, Bernard S. Meyerson, CTO for IB tems and Technology Group and a of Vandebroek's since the early when they worked together in Thomas J. Watson Research Cent she maintains her modesty."

These days, the commute is a r 12 minutes from her door to Xero

r goal
Xerox:
w
mos to
sales
ng

ster campus, but Vandebroek's latest job will be a big challenge. Despite a remarkable financial turnaround since its near-bankruptcy in 2001, the Stamford company hasn't been able to get sales momentum. Much to the dismay of Wall ;, revenue has been stuck at $15.7 1 for the past three years despite a of product introductions—49 last alone. Tough rivals such as Canon Ricoh can now more quickly copy erox breakthrough. "It's very tit for says Peter Grant, an analyst with er Inc.

hough Xerox and its famous Palo Research Center (PARC) have in- l everything from photocopying it- the laser printer and the Ethernet, sometimes been criticized as slow velop important commercial prod- But analysts, including Grant, say ice is growing that recent introduc- ure winning good market share. It's particularly well with color copiers, uct with four times the profit mar- f black-and-white copiers.

debroek sees opportunity not only omized and color printing, but also ost of emerging technologies that ttle to do with the printed word. At nt Wharton School speech she ased a voice-activated system that astronauts are using to navigate h manuals while keeping their free. Her people are also working ovations in document services.

researcher and lab chief, Vande- nas a reputation for pushing inno- s, including solid ink and special- ners, into new and higher-margin tions. "One of her strengths is be- e to think beyond today," says Ur- I. Burns, president of Business Operations for Xerox, "to think if ve something that works today, n you tweak it? Make it better for a r field?"

ING CURVE

ISM SEEMS A prerequisite for a ere taking the wrong path can eas- millions. So is a lot of hard work. roek's typical workday, when Webster, starts at 6:40 a.m., mak- akfast for Elena, 17, Arno, 15, and 13. At 7:15 they're on the school l she's working out on her rowing machine while listening to the BBC news on satellite radio. At the office, the day is usually packed with meetings, many with participants piped in from one of the four other research centers she oversees around the world. On a January day, Vandebroek, dressed in a stylish pants suit with a silk scarf and high-heeled suede boots, rushed from one meeting to the next, often stepping aside to clear the e-mail from her BlackBerry or sip from her ever-present 1-liter bottle of lime seltzer. She tries to be home by 6:30 to dine with her kids. Then she spends most nights reading printouts of e-mails she couldn't get to earlier in the day.

A master of efficiency, Vandebroek had to teach herself not to be all business at work. In her early days as a manager she was so focused on getting the job done that she assumed everyone would buy her arguments on logic alone. An executive coach assigned to her as part of Xerox' talent-development program advised her to open up, talk about herself. Vandebroek laughs remembering the surprise of her staff when she opened a Monday morning meeting with a discussion of her weekend ski trip. Soon she was coordinating Thursday evening team outings for chicken wings and beer. The only rule: No talk about work. "It's about the human fabric of the organization," she says, "taking the time to listen to [employees'] concerns."

Still, for years many at Xerox didn't even know she was a widow. After her husband's death, Vandebroek plowed herself into work. In speeches, she often quotes a Chinese proverb that has guided her: "In crisis there is opportunity." Beyond the good that her focus on work has done for her career, Vandebroek sees ways in which her family has grown stronger since the tragedy. They are a close bunch, and she describes her children as "compassionate," a rare trait in any teenager.

Vandebroek was drawn to science early on. Dreams of being an astronaut took root at age seven, when she watched the moon landing on her grandmother's television in Belgium. Today she worries that too few kids in the U.S. understand the importance, value, and excitement of a career like hers. To stoke that interest, she regularly speaks on college campuses and has taken an active role in judging and supporting a national competition for inventors aged 10 to 17. Vandebroek actively involves her children in her scientific world, drafting them to help write speeches she delivers to students. She's particularly proud that her daughter, Elena, who will enter Cornell University next fall, and Elena's best friend are both going into engineering. "I tell them: 'You guys can change the world!'" ■

BIO

Sophie Vandebroek

From her youngest days, she dreamed of science, and she dreamed big

HIGH PRIORITY With her mother and kids

BORN Feb.17, 1962, Leuven, Belgium, one of four. Her father was an engineer and CEO of Interbrew SA; two abstract works by her mother, a poet and artist, hang in Vandebroek's office.

EDUCATION Masters degree in electromechanical engineering, Katholieke Universiteit (Leuven), 1985; PhD electrical engineering, Cornell University, 1990.

EARLY AMBITION Resolved to become an astronaut at age 7 while watching the moon landing on her grandmother's TV.

CHILDREN Elena, 17, Arno, 15, and Jonas, 13. All are interested in careers in science.

GREATEST CHALLENGE Losing her husband and best friend, Bart, to a severe asthma attack, when she was 34.

HOW SHE UNWINDS Traveled to Africa four times in the past three years, once to Tanzania, once to Uganda, and twice to Morocco. Recently read *Memoirs of a Geisha* and *The Kite Runner*. She Rollerblades, skis, and camps.

PATENTS HELD 12, all of them in microelectronics.

POINT OF PRIDE Of the 104 engineers hired at Xerox R&D last year, 34 were women, nine were African American, and eight were Hispanic.

COMMENTARY

BY AMY BARRETT

'These Chemicals Are So Deadly'

Hazardous material transported by rail is vulnerable to attack. Here's what to d

THE U.S. GOVERNMENT'S INability to anticipate the September 11 attacks in 2001 amounted to a "failure of imagination," according to the committee that investigated the tragedy. Well, imagine this: Terrorists plant a bomb beneath a rail car carrying deadly chlorine gas. The bomb explodes near the National Mall in Washington on July 4, when 500,000 revelers are gathered for fireworks. Within 30 minutes as many as 100,000 could be dead or seriously injured, according to the U.S. Naval Research Lab.

At the moment, public concerns about key infrastructure are focused on the management of some operations at six U.S. ports, which may pass from a British company to the government of Dubai. But railroads could present just as tempting a target to terrorists, and in the years since September 11, little progress has been made toward protecting them. According to the American Association of Railroads, about 1.7 million carloads of hazardous materials are transported on rail lines every year. The cars are easily identifiable, and the routes are hardly a secret. Even minor mistakes can be catastrophic. A derailment last year involving a chlorine car in Graniteville, S.C., killed nine people and put 75 in the hospital. "These chemicals are so deadly, and they are shipped through our urban areas in large quantities," says Richard A. Falkenrath, former deputy homeland security adviser to the President.

Yet the problems of safeguarding the transport of "hazmats" are not intractable. Here are some steps that would greatly ameliorate the risk:

PERMIT LIMITED REROUTING Last year city council members in Washington pushed through a measure forcing the railroad CSX Corp. to divert shipments of hazardous materials that would otherwise run near the Capitol to less populated areas. CSX and the federal government are now fighting the ordinance in court. Some experts contend that the District of Columbia lacks authority to interfere with interstate commerce. That has not stopped Baltimore, Chicago, and Cleveland proposing similar measures.

The railroads argue that changing the routes could s cantly increase the amount of time hazardous cargo is tracks while sending the material out on less suitable an safe rails. Theodore S. Glickman, a professor at George ington University, says that in some cases rerouting m safer, but that railroads resist because they might have to off cargo to competitors. The solution, says Glickman, is gage a neutral body to rule on a case-by-case basis.

MASK THE CARGO Railcars with hazardous materials cu carry placards bearing easily visible identification nu Those numbers are a code for the material in the cars a spelled out in widely published manuals to ensure that gency responders know exactl hazards they face. But the co equally available to would-be ists. The solution: Replace th ards with electronic tags that i the contents of each car to poli first responders. "Right now i easy for the bad guys," says Ja Blaze, planning director with portation consulting firm Zet Associates Inc.

GRANITEVILLE The 2005 wreck, from a video of a responder at the scene

MONITOR THE HAZMATS Globa tioning systems, electronic ta and other techniques can p minute by minute informat the location and condition locomotive and car on the says Steven R. Ditmeyer, a sor at the National Defense sity. Some of this technology is in place already. But t roads don't have tracking capability everywhere sometimes they can't access temperature or other infor captured on sensors installed by companies that le cars. These systems need to be put in place so the loca all hazmats can be pinpointed at any time, and data b the railroads and shippers need to be integrated.

FIND AND USE CHEMICAL ALTERNATIVES The best way to cu on risk is simply to ship fewer dangerous substances first place. Some water-treatment plants have begun tuting substances such as sodium hypochlorite for po ly lethal chlorine. Users of these materials must keep pressure on chemical companies to find substitutes w ducing their reliance on the most hazardous substa the end the best solution will be to eliminate the tar just reroute it. ■

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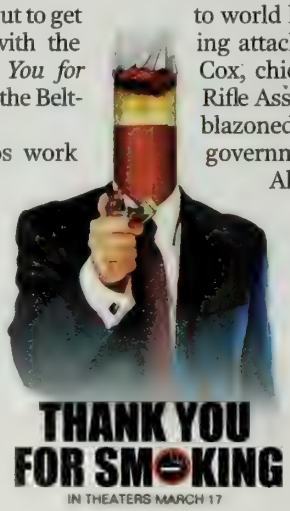
It's Hard Out Here For a Lobbyist

As Hollywood takes aim, the gun, liquor, and tobacco guys fire back—over steaks

BY EAMON JAVERS AND LORRAINE WOELLERT

TRUTH BE TOLD, THERE are few smoke-filled rooms in Washington these days. The city council is set to tighten its smoking ban, and Big Tobacco simply doesn't loom as large as it once did. But the public view of billion-dollar deals in dark corners and arm-twisting behind closed doors is about to get a Hollywood endorsement with the Mar. 17 premiere of *Thank You for Smoking*, a gleeful lampoon of the Beltway's culture of spin.

Thank You's three amigos work for the alcohol, tobacco, and firearms industries and call their lunch bunch the M.O.D. Squad, for "Merchants of Death." The central character, menthol-smooth tobacco spokesman Nick Naylor, played by Aaron Eckhart, sets the scene with a simple observation: "This profession requires a moral flexibility that goes beyond most people."



The real-life M.O.D. Squad doesn't have weekly lunches. But *BusinessWeek* assembled just such a group on Mar. 7 to ask: Do Sin Industry lobbyists lose sleep at night? First, the lobbyists—who prowl Gucci Gulch and spin the press and the Hill on tobacco, guns, and booze—screened the film. (One liquor lobbyist declined our invitation, fearing that his industry would be tarred by associating with...tobacco.) Then they dined at Washington power restaurant The Palm with Christopher Buckley, author of the 1994 book that inspired the movie. There, they reflected on their careers.

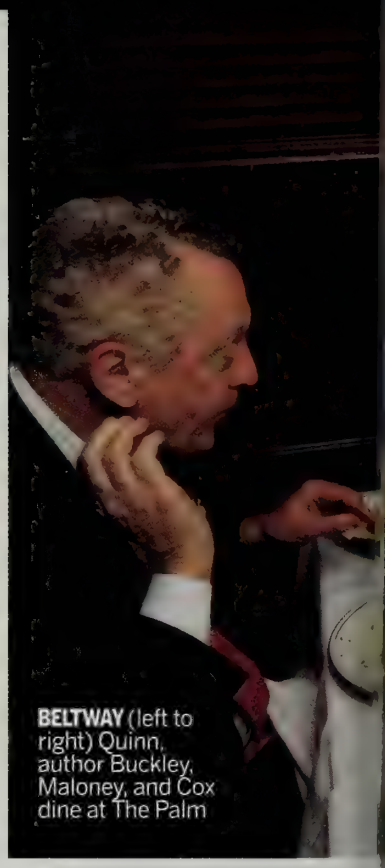
The collective theme: It's hard out here for a lobbyist.

The uproar over the illegal dealings of Washington influence peddler Jack Abramoff has drawn global attention to an industry that would rather duck and cover. Congress is contemplating new curbs on lobbying, and K Street is under assault as never before. "We've all been blamed for everything from smallpox to world hunger, so we're used to being attacked unfairly," says Chris W. Cox, chief lobbyist for the National Rifle Assn., who sports cufflinks emblazoned with the seal of his favorite government agency: The Bureau of Alcohol, Tobacco, Firearms and Explosives.

At dinner, everyone imbibes, but no one lights up, and no one admits to packing heat. These Gucci Gulchers don't wear Gucci shoes—the fine Italian leather can't hold up to long hours walking the corridors of power. And Rolexes? A digital Timex does the job.

Over steak and cabernet, *BusinessWeek*'s M.O.D. Squad pleads its case. Like Nick Naylor, the lobbyists say they're just earning a paycheck, defending legal products and the rights of Americans who smoke, drink, and own guns. Sure, they get confronted at cocktail parties, but "when you defend a civil right that's in the Constitution, it's a pretty easy argument," Cox says.

And as you might expect from paid professionals, they know how to spin. Thomas H. Quinn, a partner at the law firm Venable LLP, whose long list of clients includes UST Public Affairs, an arm of the



BELTWAY (left to right) Quinn, author Buckley, Maloney, and Cox dine at The Palm

maker of Skoal and Copenhagen sn less tobacco, makes a full frontal as No apologies here. "Lobbyist is the noble profession," he says. "It used clergy and schoolteachers. But the h calling is a lobbyist. The only busin protect the little man against the op sive government is a lobbyist."

Hollywood has a less flattering vi course. Tinseltown's version of a lo "sits astride a set of moral ambig and rides them like a water bug," sa thor Buckley. (Other Washingtoni the film fare no better: Neither Holmes, as a seductive reporte William H. Macy, as an opportunist ator, sets a high moral standard.) F fellow diners don't see any hypoc their work. "We wouldn't say it didn't believe it," says Drew Malone has represented the trifecta of products—guns, booze, and tob over the years.

At the end of the day, lobbying i about wrapping your product in pie, God, and the flag. It's long hou litical maneuvering, and never forg the basic rules. First, "Never talk v tape recorder is on," Quinn says i tape recorder. "Never write an down. Never talk on the telephone can talk face-to-face. And never you can wink."

Unlike Naylor, who in the movi

Today, Kerry is back to being just another Democrat from Massachusetts. And the NRA? "Our approval ratings are higher than the President, the Democratic Party, and the Republican Party," Cox says.

"Higher than the President and the Vice-President combined!" quips Quinn, a lifelong Democrat.

Washington's population of lobbyists has doubled since 2000, an acknowledgement by Big Business of the ever-increasing power of Big Government, even in GOP hands. "I think it was [FedEx Corp. CEO] Fred Smith who said, 'I never worry about my competition putting me out of business, but I'll always worry about those bastards in Washington putting me out of business,'" says Cox.

The head count for the Sin Industries, according to researchers at *lobbyists.info*: More than 60 button-holers, on staff with gun groups and companies as well as lobby firms, for firearms; almost 200 for beer, wine, and liquor; and 170-plus for tobacco. (The Tobacco Institute, which served as the model for *Thank You*'s fictional Academy of Tobacco Studies, was forced to close up shop in the 1998 settlement of smoking lawsuits brought by the states.)

TOWN The Squad from *You for ng*

> "We've all been blamed for everything from smallpox to world hunger, so we're used to being attacked unfairly."
>
> *—Chris W. Cox, chief lobbyist for the National Rifle Assn.*

a star turn before a Senate committee, real-life lobbyists work hard to becoming public faces. When ess calls, Big Tobacco, Alcohol, or will send an industry executive, ired gun. But anyone who testifies e coached in the cardinal rule, hat's where people like Quinn n. "Never blurt out the truth," he ients. "Stick to the script. When rt out the truth, that's what gets dy in trouble."

y from the witness table, lobbyists are relentlessly opportunistic. During the 2004 Presidential campaign, Senator John Kerry's handlers may have thought putting their candidate on TV with a shotgun and hunting gear would show voters that the candidate was a red-blooded American. The NRA immediately smelled blood—and a way to push its agenda and favored candidate, President George W. Bush. Within 30 minutes of Kerry's foray into a goose pit in Ohio, Cox was on a plane to the state, where he held a press conference blasting the senator for posing with a shotgun that would have been banned by legislation the lawmaker had supported in Congress.

Buckley's book, and the movie made from it, skewers exactly these types of Washington players. But he nonetheless sees the romance of it. "These guys get to have more fun than most other lobbyists," he says. "Who would you rather hang out with—the people from the cancer society, or these guys?"

Sure they're fun. But do they ever stop spinning? Even after four bottles of wine, the message is still exquisitely controlled. "Off the record, we'll have a really good conversation," says Quinn, pointing to a rolling tape recorder. "If this machine wasn't working I could really tell you something." ■

CHICAGO FLORIS
Puente doesn't
think the benef
the Net outwei
drawbacks

Why the Web Is Hitting a Wall

U.S. Internet growth is stalling. And it's not just the old or poor who are living offline

BY ROGER O. CROCKETT

THESE DAYS, GETTING answers to most questions seems like a no-brainer. For everything from who won an Olympic speed skating race to when to plant tomatoes, most people turn to Google or one of its rivals.

Not John W. Rogers Jr. The CEO of Ariel Capital Management LLC doesn't use the Internet at work or at home. The 47-year-old Princeton University grad thinks the Net is largely a waste of time. Assistants print out e-mails for him and researchers give him paper copies of Wall Street analysts reports from the Web. He prefers to spend his time reading, talking directly with his staff, working out at the gym, or spending time with his teenage daughter. "If you're spending all your time on e-mail, you're not listening and reading," says Rogers, who rarely took lecture notes while he was a student so he could listen more intently. "I listen and read; e-mail is a huge distraction."

It's a sentiment that many Americans find hard to imagine. Plowing through e-mail has become part of the daily routine, like brushing your teeth or walking the dog. But Rogers isn't as much of an oddity as it might seem. Despite its popularity among teens and techies, and its use in mo fices, the Internet is far from ubiqu In fact, 39 million American house still do not have Internet access. means only 64% of households ar nected, according to a recent sur 1,000 people by Dallas researcher Associates. An even bigger surpr that the growth of the Internet U.S. has stalled. Despite cheaper and faster speeds, analysts expect u to creep just one percentage poi year, to 65%, and to only 67% by 2

Many people are non-Netizens f vious reasons. They can't afford ser live in remote areas without hope fordable connections. And some a the age when they want to adop technology. Says Jeanette Lama "I'm too old to start that stuff." B spectrum of naysayers also includ lions of well-off, educated, and y professionals. Of the survey respo who say they don't use the Web make more than $50,000. Some the Netphobes attended or graduat

or have at least some associate de-
training. And 29% are 44 years old
ounger. "It's not just everyone's
dmother who is avoiding the Inter-
' says John C. Barrett, director of re-
ch at Parks Associates.

S A HASSLE"

ARE PEOPLE saying no? Some wor-
fter hearing about online scams and
al viruses, that the Net isn't safe. Oth-
wear that, for all the brouhaha about
Net's ability to enhance communica-
e-mail and instant-message chats
t down social interaction. But the
der issue is that—despite innovations
make it possible for people to call up
bank accounts with a few clicks of
ouse, watch the latest episode of *The
Show with Jon Stewart* on a PC, and
online games against competitors in
a, France, and South Africa—the In-
t remains too complicated and costly
huge swath of American society.
en Pappas, a 39-year-old who works
finance industry in New York City,
villing to go through the headache of
ng out a computer, having it deliv-
and setting up an online connection.
a hassle and it's expensive," Pappas

They Say No to the Net

Despite lower prices and faster speeds, the percent of U.S. households with access to the Internet is hitting a plateau, at about 65%. Here's who's not browsing:

OLD SCHOOLERS Nearly 60% of people 65 or older do not use the Internet at all. Among people 45 or older, 33% aren't connected.

OSTRICHES Nearly 6 million households, 5% of U.S. homes that have a PC but not Net access, won't subscribe at any price. Another 1% would if it cost less.

WORKER BEES Some 31% of these nonusers say having access at work is sufficient for their Internet needs.

WEB HATERS About 1 million of these nonusers, or 18%, say they are not interested in "anything" on the Internet.

Data: Parks Associates

says. "I would rather spend the money on fun things."

Other consumer electronics gear is much more widely adopted: Nearly 100% of U.S. households have a TV, 83% have a DVD player, and 78% have a cell phone. Despite their particular drawbacks, all these technologies are easier to use than an Internet-connected computer. Yet, while the tech industry has vowed to make its products simpler, companies keep stuffing online services, PCs, and other devices with complicated new features. That's why predictions of a few years ago that 75% of American households would be online by now have fallen short. "Innovation is rarely seen as taking things away or making them simpler," says Steve Jones, a senior research fellow for the Pew Internet & American Life Project in Washington. "We've had so much time to come up with a computer and Internet that are easier to use and work better, but we haven't done it."

It's little wonder that millions of people don't like or trust the Internet. Take Sylvia Goodwin, a 57-year-old assistant attorney general in Tucson. She has a PC at home but no Net service. That puts her among the 31% of households that say they will

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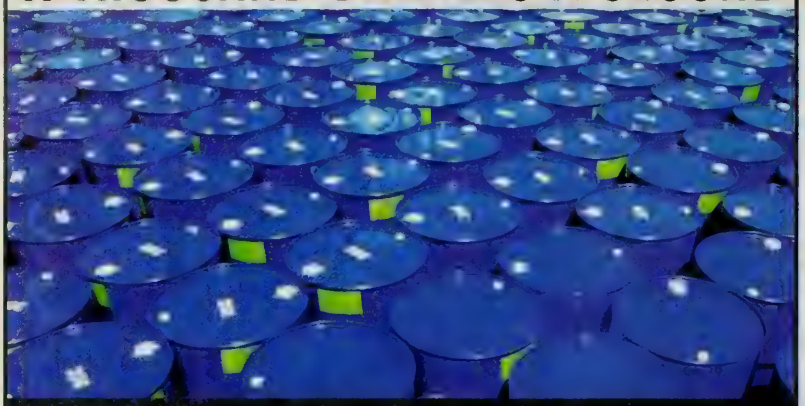
"[Tertzakian's book] explains the truth behind the real energy crisis."

—Dave Liniger, Chairman, RE/MAX International

A THOUSAND BARRELS A SECOND



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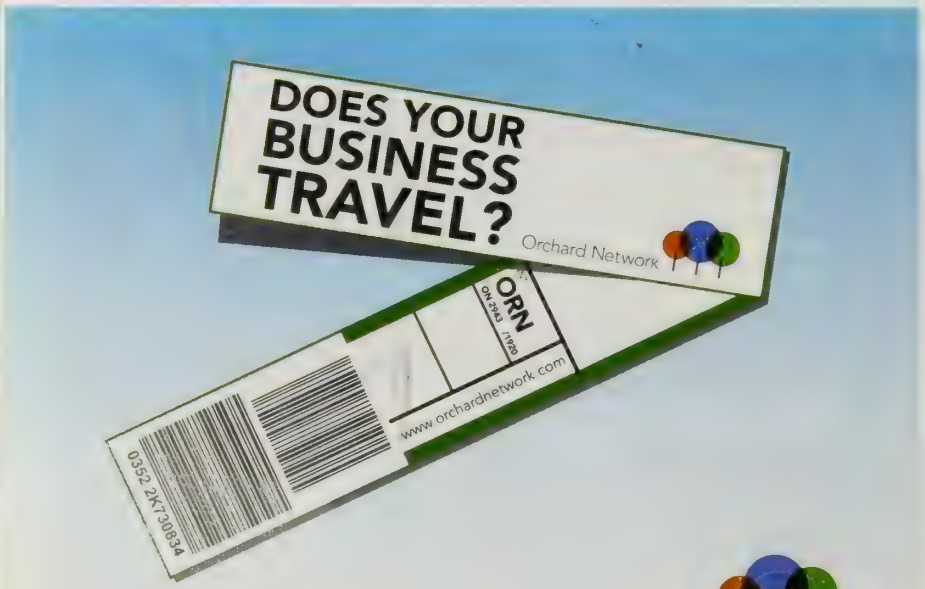

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not subscribe to an Internet servic
cause access at work is sufficien
Goodwin, the Web is a 21st century
ifestation of the world depicted in G
Orwell's *1984*. As a prosecutor, Goo
knows how easy it is for Big Broth
gain access to personal informatio
her, giving out addresses, telep
numbers, and credit-card inform
online seems like a surefire way t
control of your privacy. "If you do e
thing on the Internet, someone can
and pick it up," she says.

For others, the Internet is an exam
what author Neil Postman called "the surrender of culture to technology." From Silicon Valley engineers to teenage geeks, tech enthusiasts see only what the Net can do, not what it might undo. But James J. Mitchell, a retired banking executive from suburban Chicago, believes the Web dismantles face-to-face co
nication. He's part of the 18% of
holds that, according to the Parks s
have a computer but aren't interes
"anything" on the Internet. T
Mitchell oversaw his company's
strategy a few years ago, he never
mail at work. Instead he watched
become enslaved to it. Mitchell say
messages were trivial and undermi
more intimate forms of communi
he favors—in person or on the pho
you want to talk to me, you shoul
personally," he says. "I don't nee
and read every idle thought you ratt

Faster a
cheaper
Interne
service
holds n
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refusen

For Chicago flower shop owner
Puente, it's less a frivolity than a dis
of the simple life. After a day spent
ing blooms and logging deliveries,
year-old is content to go home, sit ba
watch *King of Queens* or *Boston Legal*
She doesn't think the benefits outwe
technical headaches or possible s
problems. Instead, she feels people
difficulties for themselves by shopp
line or paying bills over the Intern

Puente doesn't even have a comp
home. That would mean spending
$1,000, plus an additional $15 to
month for Internet service, not to
the inevitable upgrades. "You alwa
to buy some new software to make
er," she says. "What kind of juice
be getting out of it? Nothing." ■

1 Employer's Guide to Recruitment, HR Management and Compensation

ual compensation cost increases moderated for civilian and private industry workers for the year ended December 2005, compared with their over-the-year increases for December 4. Compensation costs for civilian workers increased 3.1 percent for the year ended December 2005, which was lower than the 3.7 percent over-the-year increase for December 4. Compensation costs in private industry rose 3.0 percent in the year ended December 2005, slowing from a 3.8 percent increase in December 2004. In contrast, compensation s increased 4.1 percent for State and local governments for the year ended December 2005, which was greater than the over-the-year gain of 3.5 percent in December 2004.

Title	AK	CA	MT	NV	OR	ID	WA	WY
vertising & Promotions Mgr.	$52,230	89,300	52,240	68,020	64,410	44,950	109,130	58,190
blic Relations Mgr.	$64,950	95,630	46,060	79,820	64,430	54,280	94,230	50,000
ancial Mgr.	$72,570	104,030	60,370	84,850	88,270	60,610	96,560	64,720
chasing Mgr	$67,750	84,540	67,720	77,650	77,300	60,640	86,770	66,980
d Service Mgr.	$34,111	55,130	28,560	47,560	44,400	30,190	73,240	37,160
ims Adjuster	$66,720	59,830	37,340	42,450	45,760	35,410	51,320	39,190

Source: U.S. Department of Labor Bureau of Labor Statistics

Answers, Inc.

Vhat Employers Need to Know bout Compensation

he lengthy hibernation of employee / increases is over. As the economy guished, organizations often held the e on employee pay. While employees n't like it, they felt they had to endure Job openings were scarce, and hav- a job was better than not. Eployers were seen as less sensitive employee needs, no doubt in part ause they were concerned with the vival of their enterprises.

s the economy has rebounded and ming worker shortages are becoming eal, employers are realizing the need attend to their pay programs. Eruiting or sign-on bonuses, the dar- of the 1990's, are resurfacing. Sary surveys are being purchased and

Recruiting or sign-on bonuses, he darling of the 1990's, are resurfacing."

pa data analysis is becoming a priority. Lg term employees whose pay did not chge appreciably in the last few years ar quietly beginning to search for new oportunities at higher pay. Those who wked longer hours so their employer di't have to hire additional employees, wh suffered significant increases in healthcare costs and no corresponding pay increases, and who discovered that, in times of stress, their employer no longer appears to truly value people are far more likely to seek new jobs.

Employers need to communicate their

"As the economy advances, the last thing an employer can afford is to lose the staff necessary to capitalize on the positive market conditions."

intent regarding the potential for pay changes. They must identify key contributors and keep them committed by recognizing their valuable work. As the economy advances, the last thing an employer can afford is to lose the staff necessary to capitalize on the positive market conditions. Organizations that fail to address pay as others are ramping up their pay programs will begin to lose precious employees to their competitors, along with a wealth of priceless knowledge.

To read the full report, go to .expert-insights.com/HRanswers.asp

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An Employer's Guide to Recruitment, HR Management and Compensation

For the year ended December 2005, compensation costs in private industry increased 3.3 percent for goods-producing industries, lower than the increase of 4.7 percent for the y ended December 2004. The rise in compensation costs for manufacturing moderated for the year ending December 2005, advancing 3.4 percent compared with the 5.0 percent g in December 2004. In contrast, compensation costs for construction rose 3.7 percent in December 2005, compared with a 2.4 percent gain in December 2004.

Job Title	AK	CA	MT	NV	OR	ID	WA	WY
Marketing Mgr.	$71,800	114,450	90,510	87,650	89,680	79,670	116,650	73,02
Sales Mgr.	$60,260	109,150	97,270	83,960	94,020	56,700	106,880	61,03
Human Resource Mgr.	$76,030	104,000	82,810	80,070	84,560	69,570	94,650	60,44
Education Administrator	$57,970	88,360	77,590	99,050	74,870	69,750	80,930	77,64
Lodging Mgr.	$39,240	49,310	51,410	56,010	44,670	27,360	74,690	33,96
Purchasing Agent	$54,010	59,830	50,450	75,920	43,480	41,110	64,960	44,14

Source: U.S. Departme Bureau of Labor Statis

Oasis Outsourcing

Become an Employer of Choice: The PEO Value Proposition

It may be cliché, but a company's most valuable asset is truly its employees. Small and medium-sized business owners and managers recognize that they must offer a solid benefits plan and employ sound Human Resources (HR) practices if they want to recruit and retain the best and the brightest in today's competitive labor market. Often times, however, they do not have the time, expertise or resources to adequately manage this process. Partnering with a Professional Employer Organization (PEO) can help with these issues.

Most large PEOs provide a broad range of products and services including comprehensive healthcare benefits, payroll services, workers' compensation and risk management services, staffing services, as well as HR services provided by a team of certified HR professionals. Offerings can include access to comprehensive medical plans, Flexible Spending Accounts (FSA), Health Savings Accounts (HSA), and 401(k) plans, to name a few. Additionally, businesses may realize a reduction in overall human resources-related costs due to economies of scale and the enhanced expertise of the PEO.

This is how it works: PEOs share employment relationship responsibilities with their clients and act as the administrative employer by providing HR products and services. Clients act as the worksite employer, retaining supervision of employees and business management. This creates a win-win situation for management and employees alike. Managers can focus on the productivity and profitability of their business without the distractions of ever-changing, complex human resources responsibilities; and employees typically gain access to enhanced benefits and HR services.

> ***"According to the Society for Human Resource Management, three-quarters of Americans are actively or passively on the hunt for new jobs."***

According to the Society for Human Resource Management, three-quarters of Americans are actively or passively on the hunt for new jobs. It can be difficult for smaller companies to compete with larger corporations when it comes to benefits and employment practices, but a PEO can help put them on a level playing field with a Fortune 500 company.

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n Employer's Guide to Executive Compensation

xecutive compensation is a perennial hot topic. But for investors, recruitment andidates, and others, it's important to compare any company's compensation benchmarks for its industry and businesses of similar size. Consider, for xample, the average compensation for Fortune 500 C-level executives and irectors, derived from the Board Analyst database.

ational Average Compensation for F500 Executives and Board Members

Board Member	$128,844.97
CEO	$2,964,675.00
COO	$2,420,245.00
CFO	$1,215,951.31

Chief Executive Officer National Avg. $2,420,245.00

stian & Timbers

lacement Rate Disclosure Redefines earch Industry Standard

usinesses across the globe are y being held to a higher standard ransparency and accountability in r operations. Similarly, corpora- s have a right to expect full disclo-, as well as performance, quality results, when hiring an executive ch firm. There are true distinctions ng search firms, so it's important k probing questions to learn about m's expertise, business philosophy success record.

rbanes-Oxley regulations are part of ightened global emphasis upon er transparency. Against this back- , a new pace is being set within the ch industry, as clients increasingly nize that placement rates, rather revenues, are the best indicator of ty and performance.

e mutual fund industry offers an omparison. For investors, the key ure of a fund's success is its net n, rather than its asset size. n is what led the investor to se that fund.

despite the trend toward greater arency in other industries, most h firms remain reluctant to dis- their placement rates. That's sim- ot acceptable. Potential clients a right to ask for, and be given, this essential indicator. Indeed, the placement rate should be audited by an independent entity.

Companies should not be distracted by the industry's norm of discussing "completion rates," which measure only those searches no longer being conducted. In executive search, the true measure of success is the placement rate, which measures those searches that have successfully placed a world-class candidate in the chair.

" In executive search, the true measure of success is the placement rate, which measures those searches that have successfully placed a world-class candidate in the chair."

A client's goal, of course, is a successful placement. Responsible search firms should conduct business with an openness that leads to accountability and placement results. For more ways to evaluate a search firm's practices and performance, visit the webpage below.

To read the full report, go to

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How Much Are Execs Really Paid

Even when companies are more forthcoming, the to haul can be elusive. **BY ANNE TERGESEN**

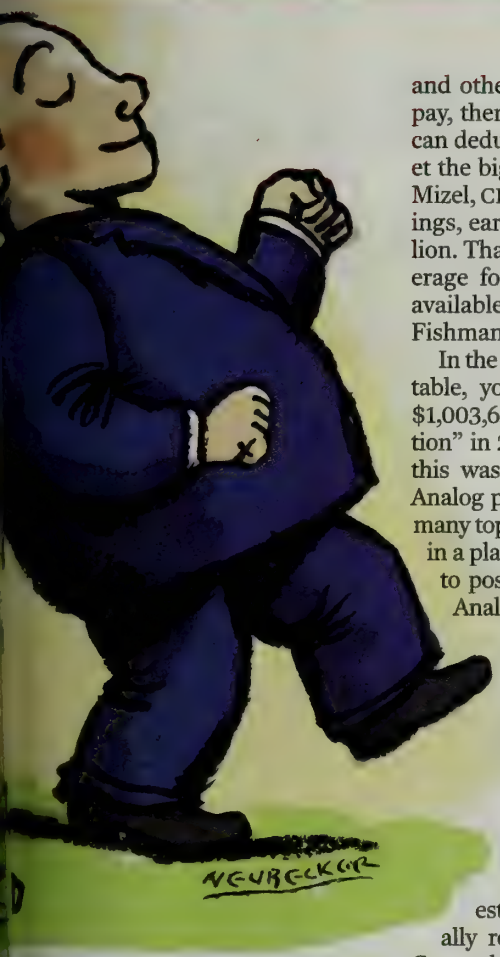
WHAT DID JERALD FISHMAN, PRESIDENT and chief executive officer of Analog Devices, earn last year? A table in the Norwood (Mass.) semiconductor maker's recent proxy statement shows $2.35 million in salary, bonus, and "other" compensation. But if you dig through the fine print and crunch some numbers, you'll see that the $2.35 million is just part of a total package worth as much as $12.7 million, depending on the method you use to compute it.

Compensation specialists say pay packages for top executives and the rules for disclosing them are so complex that even they have a hard time figuring them out. Coming up with a total price tag means assigning a number to every benefit and sorting out what portion of a stock option grant belongs in this year's paycheck, vs. last year's or next year's.

That's why the Securities & Exchange Commission recently proposed sweeping changes to the disclosure of executive compensation. Among other things, regulators want companies to do the math for investors and publish total compensation—including some items that now escape disclosure—for the CEO, chief financial officer, and three other highest-paid executives. If adopted, the changes are likely to show up in proxy statements this time next year. But some firms, including Analog, Avaya, and Pfizer, have already improved their disclosures, says Mark Borges, principal at Mercer Human Resource Consulting. While Analog doesn't include all the details the SEC wants, its proxy gives an idea of what to expect.

Current disclosure rules are partly to blame for the difficulty of calculati pay. Loopholes allow some forms pensation to be partly or entire cealed. Companies also routinely fine print summaries of agreeme put them on the hook for fat golde chutes and retirement plans. Whil holders must be told these agreem ist, they needn't be told their es value, although they can add up to of dollars. For example, Delves Gr mates that MBNA owed CEO Bruc monds $102 million after it was a by Bank of America. If the SEC way, companies will have to estin tential payouts in the proxy.

So how much did Analog's F earn in 2005? Download the co proxy statement at analog.com or (find form "DEF14A"). Flip past tions on nominees to the board of and director pay to the "Summa pensation Table" (table 1, in a se executive compensation). Here, y the salary, bonus, and stock optio Analog handed its top executives ing Fishman, over the past three y



cause U.S. tax law doesn't allow anies to deduct more than $1 mil- of an executive's salary, most firms it below that threshold, says Dennis ford, an accounting professor at the rsity of Georgia. Fishman's salary— 935 a year—is no exception.

contrast, when it comes to bonuses and other forms of performance-related pay, there's no limit on what companies can deduct. As a result, CEOs often pocket the big money on these awards. Larry Mizel, CEO of home builder M.D.C. Holdings, earned a 2005 bonus of $20.5 million. That far outstrips the $1 million average for 2004, the most recent figure available from the Corporate Library. Fishman's take: $414,445.

In the next column of the compensation table, you'll see that Fishman received $1,003,632 in "Other Annual Compensation" in 2005. According to the footnotes, this was an interest payment. Why did Analog pay its CEO interest? Because like many top executives, Fishman participates in a plan that allows him to defer his pay to postpone taxes. In a separate table, Analog voluntarily discloses that at the start of its fiscal 2005, Fishman's deferred compensation account had reached $134.5 million. Because Analog had use of that money, it paid Fishman interest. The CEO recently withdrew the entire account balance.

Still, the $1,003,632 that's listed here is only a small portion of the $8.74 million in interest the footnote says Fishman actually received in 2005. Why the gap? Currently, companies only have to count as compensation the interest they pay that's above a "market rate"—calculated by taking 120% of the AFR, or applicable federal rate the Internal Revenue Service publishes monthly. Because Analog paid its CEO an average of 6.48% while the market rate was 5.57%, the interest payment that resulted from the 0.91% difference is all that's in the Summary Compensation Table. The rest, or the $7.74 million in interest paid at the market rate, remains out of the tally—although this will change, too, if the SEC's proposals prevail. "Under current disclosure rules, interest on deferred compensation for most plans is not disclosed," says Diane Doubleday, global leader of Mercer's executive remuneration service segment.

"FAIR VALUE"

YOU'LL ALSO FIND PERKS under "Other Annual Compensation." When companies hand out perks worth more than $50,000 or 10% of salary and bonus, they're required to disclose the entire amount. The SEC plans to lower this threshold to $10,000, but some firms already divulge everything, says Doubleday. Analog lists no perks for Fishman in 2005.

The compensation table also discloses stock option awards. In 2005, Analog gave Fishman options to buy 400,000 shares. To ascertain the value of that grant, go to table 2, where companies are required to disclose either a grant's "fair value" or its potential payout under two scenarios, a 5% and a 10% annual rise in the stock price. Since the 5% and 10% projections tell you nothing about the current value of the stock option award, Beresford ignores them and calculates an approximate fair value instead. He scans the most recent annual report for the footnote on "stock-based compensation." There, Analog publishes a fair value for its employee stock options of $10.85 a share in 2005. To calculate the fair value of Fishman's options grant, simply multiply this $10.85 per share by the 400,000

On the Surface

Analog Devices' reporting of executives' compensation s further than some and is ser to the new SEC proposal

ARLS ON OPTIONS
oanies may show ns' fair value. g instead gives the t if the stock price 5% and 10% a year. in the fine print to the grant yourself.

TABLE 1 INFORMATION ABOUT EXECUTIVE COMPENSATION

Summary Compensation

The following table contains certain information about the compensation for each of the last three fiscal years of our chief executive officer, our four other most highly compensated executive officers who were serving as executive officers on October 29, 2005 and our chief financial officer:

Summary Compensation Table

Name and Principal Position	Fiscal Year	Annual Compensation (1) Salary ($)(2)	Bonus ($)(2)	Other Annual Compensation ($)(3)	Long-Term Compensation Awards Number of Securities Underlying Options(4)	All Other Compensation ($)(5)(6)
Jerald G. Fishman	2005	930,935	414,445	1,003,632	400,000	65,165
President and Chief	2004	930,935	688,892	1,269,414	[illegible]	65,165
Executive Officer	2003	930,935	40,728	2,438,272	—	65,165
Br[illegible] McAloon	[illegible]	[illegible]	143,648	[illegible]	[illegible]	[illegible]

TABLE 2

Option Grants in Fiscal 2005

The following contains information regarding stock options granted during fiscal year 2005 to the executive officers named the Summary Compensation Table:

Option Grants in Last Fiscal Year

Name	Number of Securities Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal Year(3)	Exercise Price per Share ($)(4)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(5) 5% ($)	10% ($)
Jerald G. Fishman	400,000(1)	3.13%	$ 37.70	12/07/14	$ 9,483,731	$ 24,033,636
Brian P. McAloon	65,000(1)	0.51%	$ 37.70	12/07/14	$ 1,541,106	$ 3,905,466
Robert R. Marshall	65,000(1)	0.51%	$ 37.70	12/07/14	$ 1,541,106	$ 3,905,466

STOCK OPTIONS
This is not a dollar amount, but the number of options. You need to calculate the value yourself.

options in his package. The result, $4.34 million, is very close to the fair value of $4.33 million that Analog voluntarily discloses in a separate table.

How much of that $4.3 million should you include in Fishman's 2005 paycheck? Since the grant spans five years, it's reasonable to include only one-fifth, or $866,000. Do the same exercise with past options grants, counting only the portion of each that vests in 2005, says John LaBarca, senior analyst at the Center for Financial Research & Analysis in Rockville, Md. The total estimate, $10.3 million, brings Fishman's pay package to $12.7 million (not including the $7.7 million of interest missing from the table). Paul Hodgson, senior research associate at the Corporate Library, takes a simpler approach. When calculating annual pay, he disregards options grants and factors in the "value realized" from exercising options instead. In a table, Analog reveals that Fishman netted $2.85 million this way in 2005. Whatever method you use, be consistent. And count grants or exercises, but not both.

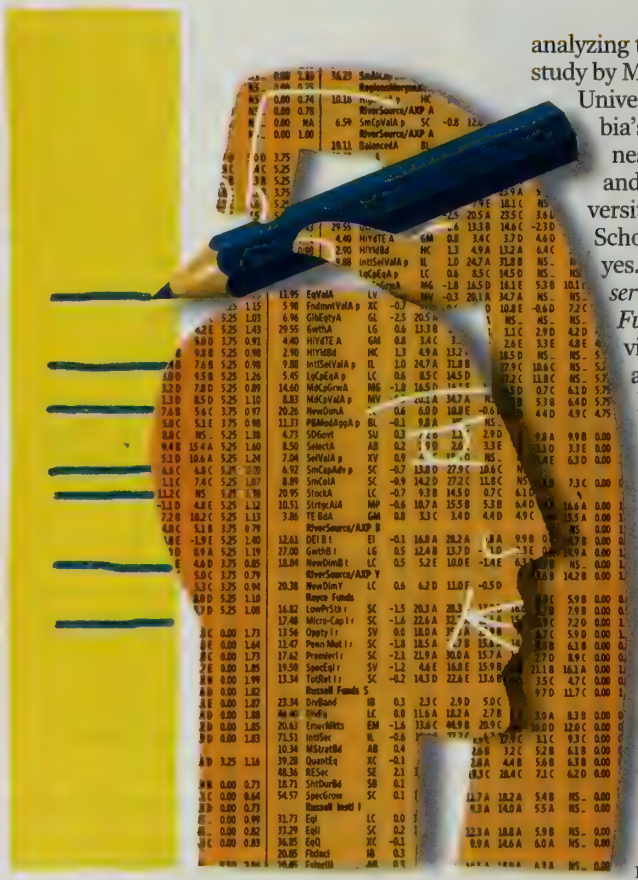
Loopholes allow some pay to be hidden altogether

The last column of Analog's Summary Table reveals that Fishman earned $65,165 in "All Other Compensation" in 2005. This is the company's matching contribution to his retirement savings.

The fine print also indicates that Fishman is entitled to a golden parachute if he leaves or is forced out within two years of a takeover or merger. Analog voluntarily reveals that as of Jan. 1, 2006, Fishman would have received $9.6 million. If the SEC gets its way, firms will be required to publish such estimates starting next year. For now, though, most proxies merely describe how much bonus and salary a CEO stands to receive in severance. Up to three times the most recent salary and bonus is common. But the biggest payouts often come from provisions such as accelerated vesting of stock options and reimbursement for a 20% excise tax on parachutes with more than three years of compensation. While you'll find details in a "change in control" agreement attached to the 10-K or in an 8-K filed in the year the agreement was signed, you're unlikely to get enough information to value the package. ■

Is Your Manager Earning His Keep?

One way to tell is to use the fund's old portfolio as a benchmark. BY LEWIS BRAHAM



WHEN MUTUAL fund managers analyze Microsoft, they compare its 2005 profits not just with those of other software companies but also with its own earnings in 2004 and 2003. They do this because they want to know whether Bill Gates and Steve Ballmer are making the right moves, regardless of how the rest of the software industry is performing.

Can the same approach be used when analyzing the funds themselv study by Marcin Kacperczyk University of British Co bia's Sauder School of ness and Clemens and Lu Zheng of the versity of Michigan's School of Business ind yes. In the paper, *served Actions of M Funds*, the author vised a way to bench a fund manager a himself. They found that whet fund beats or la individual bench has strong prec value for perform The results mean that ex evaluation me such as comp funds with co tors and in should be tossed but the findings g vestors insights the others don't.

The study an more than 2,5 versified domestic equity funds o years from the beginning of through the end of 2003 (http pers.ssrn.com/sol3/papers.cfm?ab id=676103). For each fund, t searchers calculated the performa its previous published portfolios then calculated the difference be the fund's actual performance a performance if the manager had no changes.

Think about it this way: To a say, the $38 billion Fidelity Low Stock Fund, the researchers wou the fund's June 30 semiannual

best service anticipates your needs. To give you an extra hour of sleep in business class, we welcome you with met meals before you fly. It's part of The Sleeper Service, allowing you to go straight to sleep in our more comfortable eds right after takeoff. Our goal is simple: to deliver the best service you could ask for, without you having to ask. Whether e enjoying pre-flight champagne, or more flights when you need them, we think you'll find our business class like no other.

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which includes a snapshot of its portfolio on that date, and enter all the fund's stock and cash holdings into a spreadsheet. In subsequent months they would track how that portfolio in the spreadsheet did, vs. the actual recorded performance of the fund. (They also would subtract the fund's management expenses from the spreadsheet portfolio's performance.)

Look at what the returns would be if your manager did no trading

If fund manager Joel Tillinghast did no trading at all, the spreadsheet of stocks and the fund itself would behave identically. But that rarely, if ever, happens. The question is: Are the stocks Tillinghast buys better than the ones he sells? If he's making smart trades, then the fund will outperform its old portfolio. If he's making unwise moves, then it will lag. In Tillinghast's case, the analysis demonstrates his skill: The fund outperformed its old portfolios, as measured by each semiannual report, by an average of two percentage points a year (table).

RAPID TRADING

THE RESEARCHERS also discovered that this sort of analysis has some predictive value. For each year of data, the authors ranked the funds by their performance gap and then divided them into 10 equal groups. They found that on average the managers in the top group in any given year beat the market by an annualized 1.2 percentage points over the next five years, while those in the bottom group lagged 2.2 points. In comparison, a recent study of Morningstar's ratings found that funds rated five stars in 2002 subsequently beat the market by just 0.1 point and one-star funds lagged by 1.9 points.

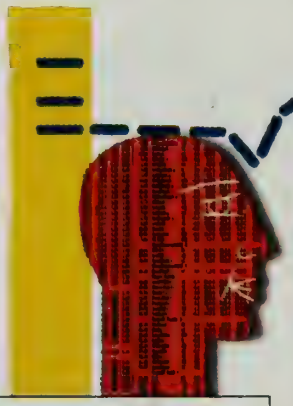
So what are the study's top-ranked funds? Co-author Sialm is reluctant to reveal them. "We don't say that each individual fund in the top-performing group will perform better but that the group as an aggregate will," he says. Still, choosing from among the best is better than from the worst. Of those, the best in 2003 included: Smith Barney Small Cap Growth, which outperformed its old portfolio by 21.2 points; Boston Company Small Cap Tax-Sensitive Equity, 21; American Century New Opportunity II, 16.6; Pimco PEA Opportunity Fund, 15.9; RS Investment Smaller Company Growth, 15.3; and Salomon Brothers Capital, 12.3. The study data ended in 2003, but the performance edge, by the authors' reckoning, should carry through 2008.

One of the surprising results was that the average gap for all 2,500 funds was close to zero. "We thought that trading costs would hurt the average fund," says Sialm, "but some funds systematically create value for shareholders by trading favorably." For instance, the rapidly trading CGM Focus Fund—which has a 327% turnover ratio, meaning it changes its portfolio more than three times a year—has an average 12.4 percentage point positive gap for its history covered by the study (just 1999 to 2003). If you look at the strategic shifts that Ken Heebner has made in the portfolio, you can understand why. He went from emphasizing raw materials to real estate, homebuilders, and energy stocks, and seemed to be always in the right place at the right time. Meanwhile, another rapid trader, ABN A Veredus Aggressive Growth Fund, suffered from moving too soon into t nology during the bear market, wi -3.37 percentage point gap for the 2 03 period. The fund continues to lag hind other small-cap growth funds.

Generally, the funds that trade most will have the widest perform gaps. Yet Sialm warns that this so analysis has limitations. "If a fund's inal portfolio of holdings happened really great or really awful, the perf ance gap won't accurately reflect the ager's skills," says Sialm. After all, manager had great stocks to begin any changes could make him look b manager with an awful portfolio will like a genius after dumping his dogs

The study doesn't account for flows into the fund, which can dilut performance of existing stocks, or flows, which can force managers t stocks. Looking at a 20 average may not help e Sialm says, because fi asset size, managers analysts change time. Still, those lems exist with rating system.

You could analyze o your own funds like though it's easier with pact portfolios rather those that hold hundre stocks. Take the Oakma lect Fund and enter i holdings into an online folio tracker (availab businessweek.com, ingstar.com, or finan hoo.com). Remember clude the cash, too. end of each quarter months, calculate the minus a quarter or half expenses and compa with the fund's actual That way you'll see w the manager is earnir keep. An analysis usir BusinessWeek Po Tracker Tool of Oak holdings from Dec. 31, through Mar. 3 sho slight lag of 0.8 perc point after deducting tion of its expenses, a for neither panic nor You'd have to track th for two or three years better read on the management.



Reading the 'Return Gap'

Researchers looked at 20 years' worth of data on mutual funds to determine their return gap. A positive return gap means the fund is adding value by trading and making portfolio changes. A negative gap suggests the manager's moves are detracting from returns. Here are data for some of the largest funds.

FUND (SYMBOL)	LONG-TERM RETURN GAP*	2003 RETURN GAP
Fidelity Contrafund (FCNTX)	0.09 †	2.17% †
Fidelity Growth & Income (FGRIX)	0.32	0.22
Fidelity Low Priced Stock (FLPSX)	1.98	2.72
Fidelity Magellan (FMAGX)	0.89	-0.38
Growth Fund of America/A (AGTHX)	-0.33	1.88
Investment Company of America Fund/A (AIVSX)	0.20	2.66
Vanguard Windsor II/Inv. (VWNFX)	-0.55	-1.19
Washington Mutual Investors Fund/A (AWSHX)	-0.26	0.21

*Although the period studied was from 1984-2003, data for some funds do not go back that far. Fidelity Low Priced Stock starts in 1993 and Vanguard Windsor II /Inv. in 1990

† Percentage points

Data: Clemens Sialm, Marcin Kacperczyk, and Lu Zheng

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Based on Market Price	12.53%	8.37%	13.87%	14.68%

Total returns are calculated quarterly using the daily 4:00 p.m. net asset value (NAV). Distributions, if any, are assumed to be reinvested back into the fund on the pay date at the NAV on that date. Performance data quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than quoted. The investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, are subject to market volatility. They may be worth more or less than their original cost. MDY shares are bought and sold at market price (not NAV) and are not individually redeemed from the fund. Brokerage commissions will reduce returns. To obtain most recent month-end performance, please call 1-800-843-2639 or visit www.MidCapSPDR.com

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My Magic Carpet Ride in India

A trip to the source makes for great adventure, but don't expect any real steals. **BY DEBORAH L. JACOBS**

SEVERAL YEARS AGO, WHEN I was looking for Oriental carpets to furnish my three-story Brooklyn (N.Y.) brownstone, a friend took me to a merchant he knew in upstate New York. I bought three gorgeous rugs, all of them made in India.

More recently my husband Ken and I decided we needed four more rugs for the house: one for our bedroom, one for the living room, and one each for the two staircase landings. This time, however, we were planning a family vacation to India and thought it would be fun to buy at the source. In December we traveled to north-central India, a major rug-production center. Our challenge was to find rugs of higher quality and lower price than we could get in New York. To see how we fared, I lined up a carpet expert back home to evaluate my finds when we returned.

We began our hunt in the city of Jaipur, where Nand Kishor Chaudhary, owner of Jaipur Carpets (jpcarpet@gmail.com), relies on a network of weavers in villages throughout the state of Rajasthan to produce the rugs he sells, mostly for export. Designs are computer-generated versions of classical patterns, in the reds, blues, greens, golds that a to Western taste We tracked Chau down through a photo credit book *Indian Carpets*, by AshaRani M which we bought in a hotel gift sho ter two rug authorities I had consu the U.S. refused to share their sou decided to scout out places once I India.) Chaudhary offered the perf lution to our quest for runners to fit regularly shaped staircase landing tom-made rugs, one a classic design with flowers and medallion the other in what looks like an Am Arts and Crafts style.

AT MARKET: Sarvar Amin (left) shows her wares to the author in Delhi

COMING TO TERMS

PRICES, BASED on the tightness weave, were $15 per square foot first rug, which had 140 knots pe and $10 per square foot for the s which had 81 knots per inch. Th tab, to cover approximately 64 squ of floor, was $937. The rugs wou about five months to weave. (Al the knot counts were relatively l were sold on the rugs' good-qualit which is durable enough for high areas, and the fact they were well for nonstandard sizes.)

Although bargaining is part of dian culture, Chaudhary wouldn't on price. Still, he agreed to ter were more important to us: payn credit card, no charge until the r rived in the Atlan his daughter rur shipping, and the return the rugs to for any reason (at pense) for a full re

When we shopped for r Delhi, I compar prices at Jaipur with those at Ob store our hotel mended. The p similar custo runners was thre as much as we p

n: Don't automatically go to places hotel sends you.

e visited Gulam Mohidin & Son, an- r lead from Mathur's book, in a resi- ial Delhi neighborhood (amin_gu- mohidin@yahoo.com). Mohomad n, a third-generation dealer who the business with his daughter, Sar- olled out some choice items from his ction of beautiful but threadbare old ets. These pieces were not for sale; uses them as types for carpets s made in Kash- Each rug had a One was ac- d from a widow eft it in the attic Bombay house, e it was dam- by a monsoon. er was saved fire at the com- s Srinagar head- ers when Amin's heaved it out a w into the n River.

our bedroom me away with a woven (342 per inch) 4-ft. garden design center field of birds perched the branches ee ($1,200). We ought a 4-ft. by ashan, a floral- lion design for a city in as once Persia, atched our liv- om (360 knots nch, $1,100). too, the dealer efused to nego- ices.

hoping to find at least one older e went to Galleria June 1st rst@hotmail.com), whose ad we in the monthly *Delhi Complete ide and Magazine*. Harash Talwar, er in the business, enlightened us he widespread practice of wash- rugs with acid, scrubbing them ndstone, and dying the fringes a to make them look old. After told us about his business per- this service for tourist shops, we extra closely at the two "old" car- e refused to estimate their age) ght from him.

n we got home, we asked Sam Noori, a carpet consultant and dealer with Zara Rugs Gallery in East Hanover, N.J. (www.zararugs.com), to critique our haul. Without telling him what we paid for any of our purchases, we asked him to appraise their quality and attach a U.S. retail price to each. Noori praised the weaving in the rugs from Galleria June 1st, but he questioned their age. A 5-ft. by 8-ft. geometric tribal design—an added purchase we made for our son's room ($700)—was "a good copy of an old rug," he said. The weave was too tight for it to be more than five years old, and without any signs of repair, it looked "too perfect." When he estimated the price at $1,000, we breathed a quiet sigh of relief.

Noori hesitated over another purchase from Gallery June 1st, a 4-ft. by 6-ft. Kashan with a teardrop center medallion. It seemed to have been rebound in spots where the edges of an old rug might have frayed. On the other hand, what we took to be abrash—shading in old or tribal carpets that results from the way different wools absorb the dye—might just be the result of acid wash applied vigorously to the red center field, Noori said. While he couldn't tell whether the rug was really old, he priced it at $500 (exactly what we paid).

Although Noori admired the tight weave, softness, wool, and durability of the rugs from Gulam Mohidin, it seems we paid dearly for the privilege of seeing Amin's collection and listening to his stories—about double what the reproductions were worth. But we're still convinced we could not have found comparable rugs in New York for the prices Noori put on them.

Where did we net out? Buying carpets in India was no bargain, but we brought home some beautiful souvenirs, didn't make a huge investment, and thoroughly enjoyed the chase. ■

RUG RULES...

- Stay away from merchants recommended by hotels, taxi drivers, and tour guides. Their commission, which gets added to the price, can be as high as 50%.
- Look for places local people patronize in residential parts of cities, where rents and prices are lower.
- Turn a rug over and examine the tightness of the weave and how close together the knots are. Rugs with higher knot counts and a tighter weave involve more work, and are generally more expensive.
- To test whether a rug is really made of silk—and not cotton or synthetic material—ask the merchant to pull out a thread of each color and light them with a match. Only the silk will quickly ignite, and then shrivel into a ball.

...AND RESOURCES

- *Oriental Rugs of The Silk Route*, by John B. Gregorian (Rizzoli, 2000)
- *Indian Carpets*, by AshaRani Mathur (Rupa & Co., 2004)
- *Rugs to Riches: An Insider's Guide to Buying Oriental Rugs*, by Caroline Bosly (Pantheon Books, 1980)

EDITED BY MONICA GAGNIER

TIME OFF

PLEASE DON'T FEED THE DRAGON

FROM 120-POUND Faust the Komodo dragon to a 5-ounce emerald-green day gecko, lizards of all stripes will be on view at Chicago's Shedd Aquarium Apr. 8 through Feb. 28, 2007. The interactive exhibit, "Lizards and the Komodo King" (Komodos are the world's largest lizard), will feature 27 species from tropical regions (sheddaquarium.org). Visitors will learn why some geckos bark and dragons grow "beards," and get the feel of different lizards at the skin-texture rubbing station. Tickets, $23 for adults and $16 for seniors and kids under 11, are on sale at ticketmaster.com. *–Abed Moiduddin*

FITNESS

A GADGET THAT FEELS YOUR BURN

IF YOU'RE TRYING to lose weight, you want to know that you're burning more calories than you take in. Unlike a pedometer, which just counts steps, a new type of exercise monitor can track every motion your body makes 40 times a second—whether you're jogging or loading the dishwasher—and convert the data into calories. Called the BioTrainer, it doesn't work for resistance training such as weight lifting (though it will calculate what you expend driving to the gym). The device is $50 at BioTrainerUSA.com, which for $10 a month also can track the calories you consume and burn. *–Larry Armstrong*

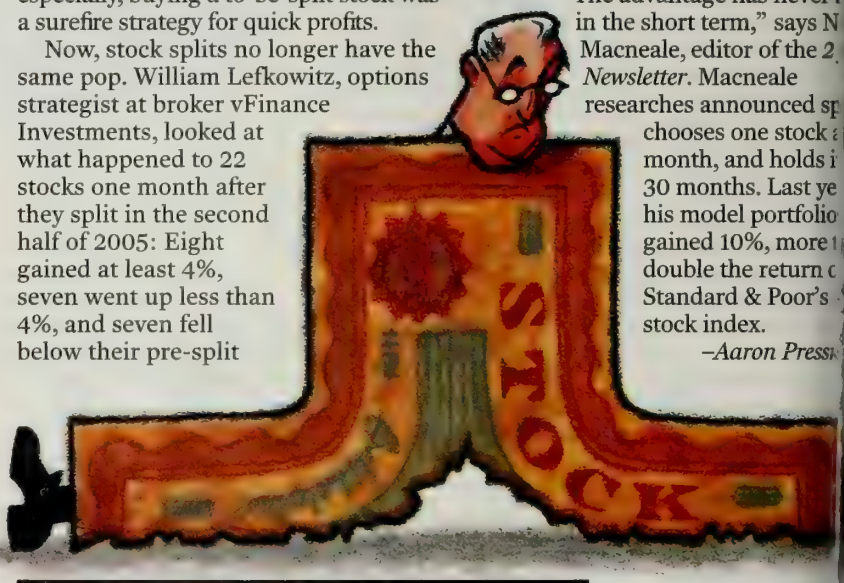
STOCKS

Patience Pays Off

THE ACT OF SPLITTING a stock does nothing for a company's sales or profits, but for decades Wall Street has taken it as a bullish sign. Why would management do it unless prospects were bright and the stock was expected to rise yet again? During the bubble years especially, buying a to-be-split stock was a surefire strategy for quick profits.

Now, stock splits no longer have the same pop. William Lefkowitz, options strategist at broker vFinance Investments, looked at what happened to 22 stocks one month after they split in the second half of 2005: Eight gained at least 4%, seven went up less than 4%, and seven fell below their pre-split price. The results were similar to a study he did in 2004, when 33 out 77 splitters lost ground.

Perhaps the payoff takes longer t it used to. Academic studies have fo that holding stocks for several years after a split remains a winning strat "The advantage has never l in the short term," says N Macneale, editor of the 2 *Newsletter*. Macneale researches announced sp chooses one stock a month, and holds i 30 months. Last ye his model portfolio gained 10%, more t double the return c Standard & Poor's stock index. *–Aaron Press*



CREDIT

WHAT'S THE DIFFERENCE BETWEEN borrowers with high cre scores and those with low ones? A recent study by Experian Consumer Direct, which provides online credit reports, sco and monitoring, looked at key statistics for borrowers with h credit scores (720 and up) and those with low scores (660 below). The high scorers had higher debt and monthly payments but far fewer late payments—barely any, in fact. also used less of their total available credit than those with scores. What also separates the two groups is the number of credit inquiries. Such an event takes place every time you apply for a loan or a credit card.

	CREDIT SCORE LESS THAN 660	CREDIT SCC 720 OR GRI
AVERAGE MONTHLY PAYMENT	$290	$72
AVERAGE DEBT (revolving & installment accounts only)	$6,661	$15,01
AVERAGE DEBT USAGE (% of available credit used)	27.7%	17.8
AVERAGE NUMBER OF LATE PAYMENTS (over the past 6 months)	2.32	0.002
AVERAGE NUMBER OF INQUIRIES (over the past 6 months)	3.07	1.4

Data: Experian Consumer Direct

NEW RAV4

Anything

e biggest
RAV4 yet
still doesn't
gas. And
30 MPG*
this SUV
gineered to
fuel economy
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ith available equipment.*2006 EPA estimate for 4-cylinder 4X2 model highway mpg.
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TOYOTA moving forward

BY GENE G. MARCIAL

AN IMPRESSIVE ARRAY OF NEW DRUGS IS SET TO LIFT ELI LILLY.

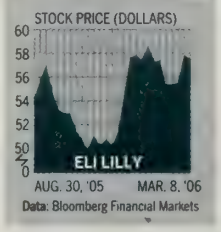
ALLIED DEFENSE TAKES AIM AT BOOSTING SHAREHOLDER VALUE

THE NEXT PHONE TAKEOVER COULD BE TIME WARNER TELECOM.

Lilly Is Starting to Bloom

BIG PHARMA HAS BEEN in the doldrums for years, ravaged by generic rivals, class actions, and trickling product pipelines. But some pockets are perking up. Eli Lilly (LLY), the global prescription drug giant, has risen more than 8% in the past six months despite wariness among analysts. Some pros say the recent lawsuits against Lilly's top-seller, Zyprexa, a treatment for schizophrenia and bipolar disorder, are already fully priced into the stock. And Lilly's new products, they say, are impressive. They predict analysts will have to raise their earnings estimates next year. "Upside forecasts are more likely [than downside ones]," argues Catherine Arnold of Credit Suisse, which has done banking for Lilly. Her earnings estimates of $3.18 a share in 2006 and $3.46 in 2007 exceed analysts' consensus forecasts of $3.14 and $3.41. Lilly earned $2.87 in 2005. It is one of the few drugmakers free of patent worry until 2011, notes Arnold—unlike Pfizer and Merck, whose big-selling anti-cholesterol products face patent expiration. Arnold points out that Lilly is developing a reformulation of Zyprexa. Another potential winner: Byetta, co-developed with Amylin Pharmaceuticals, which the Food & Drug Administration approved last May as a treatment for Type 2 diabetes. It could generate $1.2 billion a year for Lilly, says Arnold. Herman Saftlas of Standard & Poor's, who rates Lilly a strong buy, says its growth products and pipeline make it one of the most attractive big-cap drugmakers. He predicts the stock, now at 57, will hit 65 in 12 months.

IT'S SPRINGTIME



Allied Defense: Pass the Ammo

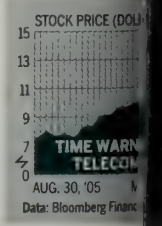
LITTLE-KNOWN ALLIED DEFENSE GROUP (ADG), a maker of ammunition and light weapons for military use, is catching the eye of some activist investors, including Pirate Capital, which has a 12% stake, and Wynnefield Capital, which owns 8%. Both take big positions in undervalued companies where they see potential, then pressure management to take steps to enhance shareholder value. Two companies where Pirate has bought in, James River Coal and Canadian resort operator Intrawest, recently hired investment banks to map out strategy. Neither Pirate nor Wynnefield returned calls. One pro who owns stock says Allied will be "looking for ways to boost its stock to get Pirate and Wynnefield off its back." Michael Hoffman of investment firm Friedman, Billings, Ramsey Group rates ADG, now at 23, "outperform," with a 12-month target of 29. He sees it earning $1.66 a share in 2006, compared with an expected loss for 2005 caused by delays in shipments. The shortfall is expected to be made up in the first quarter. ADG declined to comment.

A FEW UPS AND DOWNS

Will Buyers Call Up Time Warner Telecom?

EVEN BEFORE NEWS broke of an AT&T-Bell South shares of Time Warner Telecom (TWTC) had been winging up, from around 4 a year ago to more tha 14.60 now. The reason: Some see it as prey as the teleco industry consolidates. "Not only is TWTC steadily gainin enterprise business, but it is also attracting attention fo takeover appeal," says Donna Jaegers of Janco Partners, owns shares. Time Warner took TWTC public in 1999, retaining a 44% stake. TWTC has a fiber network connecting 6,000 buildings in 44 U.S. cities, with more than 20,000 route miles. It is profiting from the growth in demand for bandwidth, says Jaegers, mostly from corporate customers. Jaegers rates TWTC a "buy" based on the company's internal growth outlook. She assigns a buyout value of $2.6 billion, or 22 a share, at 11 times its estimated 2007 earnings before interest, tax, depreciation, and amortization of $312 mi Its No. 1 customer, AT&T, accounts for 8% of revenues. Cingular Wireless, pulling in 4.5%. Among big stockho Advance/Newhouse Communications, with a 13% stak TWTC says it's focusing on expanding its business.

CLIMBING STEADILY



BusinessWeek online Gene Marcial's Inside Wall Street is pos businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street n firms hold positions in the stocks under discussion. Similarly, they have no inv banking or other financial relationships with them.

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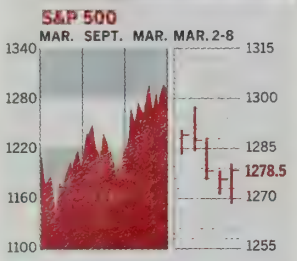
Personal Business Figures of the Week

STOCKS



COMMENTARY

Rising bond yields and a slowing real estate sector pressured stocks, but a decline in oil, which dipped below $60 a barrel, and the BellSouth buyout enabled the Dow to finish above 11,000. NASDAQ didn't fare as well: tech stocks were hurt by weakness in Google and Intel. Fed-watchers, meanwhile, were betting on another three rate hikes by the central bank.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	MAR. 8	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1278.5	-1.0	2.4	4.8
Dow Jones Industrials	11,005.7	-0.4	2.7	0.9
NASDAQ Composite	2267.5	-2.0	2.8	9.4
S&P MidCap 400	763.9	-2.7	3.5	12.8
S&P SmallCap 600	371.8	-2.7	6.0	11.5
DJ Wilshire 5000	12,855.0	-1.3	2.9	7.1
SECTORS				
BusinessWeek 50*	754.6	-1.2	1.7	2.9
BW Info Tech 100**	383.8	-1.6	0.9	6.0
S&P/Citigroup Growth	605.4	-0.8	1.5	3.2
S&P/Citigroup Value	669.4	-1.2	3.4	6.5
S&P Energy	386.1	-2.5	3.6	9.4
S&P Financials	435.8	-0.7	2.2	7.8
S&P REIT	168.5	0.2	10.1	21.1
S&P Transportation	262.9	-1.0	5.2	11.8
S&P Utilities	159.6	-2.7	-0.1	6.3
GSTI Internet	187.7	-3.5	-8.5	16.7
PSE Technology	863.0	-2.4	3.2	15.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	MAR. 8	WEEK	% CH YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1594.8	7.8	5.5
London (FT-SE 100)	5812.9	-0.5	3.5
Paris (CAC 40)	4969.5	-1.7	5.4
Frankfurt (DAX)	5673.4	-3.3	4.9
Tokyo (NIKKEI 225)	15,627.5	-2.1	-3.0
Hong Kong (Hang Seng)	15,493.1	-2.1	4.1
Toronto (S&P/TSX Composite)	11,737.1	-0.5	4.1
Mexico City (IPC)	18,398.8	-3.5	3.3

FUNDAMENTALS	MAR. 7	WEEK AGO
S&P 500 Dividend Yield	1.80%	1.80%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.7	17.9
S&P 500 P/E Ratio (Next 12 mos.)*	14.9	14.9
First Call Earnings Revision*	-1.20%	-2.01%

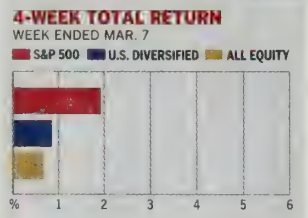
*Fi

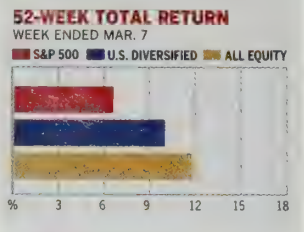
TECHNICAL INDICATORS	MAR. 7	WEEK AGO
S&P 500 200-day average	1234.6	1231.9
Stocks above 200-day average	63.0%	66.0%
Options: Put/call ratio	0.80	0.73
Insiders: Vickers NYSE Sell/buy ratio	5.25	4.85

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Photographic Products	17.0	Oil & Gas Equipment	45.3
Distillers & Vintners	8.4	Specialized Finance	43.6
Wireless Services	8.0	Oil & Gas Refining	42.6
Consumer Electronics	7.3	Steel	39.1
Metal & Glass Containers	6.5	Computer Retailers	35.9

WORST-PERFORMING GROUPS	LAST MONTH %	
Divsfd. Metals & Mining	-12.5	Automobiles
Educational Services	-11.9	Home Entrtnmt. Softw
Gold Mining	-11.0	Diversified Chemicals
Semiconductor Equip.	-10.6	Home Furnishings
Tires & Rubber	-9.3	Broadcasting

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Communications	4.0	Latin America	56.8
Real Estate	3.2	Precious Metals	36.3
Financial	2.4	Diversified Emerg. Mkts.	33.5
Health	1.9	Diversified Pacific/Asia	25.5
LAGGARDS		**LAGGARDS**	
Japan	-7.2	Domestic Hybrid	5.6
Natural Resources	-4.9	Miscellaneous	6.6
Diversified Pacific/Asia	-3.2	Large-cap Value	6.9
Precious Metals	-1.4	Large-cap Blend	6.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFds. Mble. Tlcmms. Inv.	13.0	ING Russia A	75.6
ProFds. UltTelcmms. Inv.	8.8	ProFunds Ultra Japan Inv.	68.9
ProFds. Sh. Prec. Mtls. Inv.	8.3	T. Rowe Price Latin Am.	63.8
Quaker Btch. Phrma.-Hthcre. A	7.1	Eaton Vance Grtr. India A	62.7
LAGGARDS		**LAGGARDS**	
Fidelity Japan Small Co.	-15.0	Ameritor Investment	-66.7
Ameritor Investment	-14.3	American Heritage Grth.	-42.9
ProFunds Precs. Mtls. Inv.	-12.4	Frontier MicroCap	-26.9
ProFunds Ultra Japan Inv.	-10.9	Potomac Sm. Cap/Sh. Inv.	-25.0

INTEREST RATES

KEY RATES	MAR. 8	WEEK AG
Money Market Funds	4.07%	4.05%
90-Day Treasury Bills	4.58	4.60
2-Year Treasury Notes	4.72	4.70
10-Year Treasury Notes	4.73	4.59
30-Year Treasury Bonds	4.72	4.56
30-Year Fixed Mortgage†	6.30	6.10

†Banx

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	3
General Obligations	3.88%	
Taxable Equivalent	5.54	
Insured Revenue Bonds	3.98	
Taxable Equivalent	5.69	

THE WEEK AHEAD

RETAIL SALES *Tuesday, Mar. 14, 8:30 a.m. EST* » Retail sales are expected to have fallen 0.7% in February after a hefty 2.3% rise in January. That's the median forecast of economists polled by Action Economics. Less auto sales, the January fall was probably 0.4%, after a 2.2% jump.

BEIGE BOOK *Wednesday, Mar. 15, 2 p.m. EST* » The Federal Reserve releases its summary of regional economic activity before the Mar. 28 policy meeting. All economists polled by Action Economics expect an interest rate hike to 4.75%, from 4.5%.

CONSUMER PRICE INDEX *Thursday, Mar. 16, 8:30 a.m. EST* » February consumer prices for goods and services probably inched up 0.1% following a 0.7% January surge. Excluding food and energy, February prices most likely increased 0.2% for a second straight month.

RESIDENTIAL CONSTRUCTION *Thursday, Mar. 16, 8:30 a.m. EST* » February housing starts most likely eased to an annual rate of 2.07 million.

INDUSTRIAL PRODUCTION *Friday, Mar. 17, 9:15 a.m. EST* » Factory output probably rose 0.7% in February, after a 0.2% dip in January. Warm weather led to a plunge in the January utility output. The average operating rate likely rose to 81.4% from 80.9%.

The *BusinessWeek* product rose to 270.4 for the we Feb. 25, and stood 13.8% year ago level. Before calc the four-week moving ave index inched up to 269.7.

BusinessWeek

For the BW50, more inve data, and the componen of the production index v www.businessweek.com/magazi

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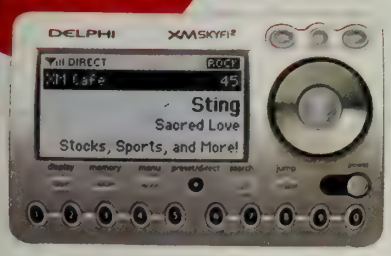

For complete details, sweepstakes rules, and to enter to win, go to
www.businessweek.com/autos/carswelove

It's about money.
Earning it.
Investing it.
Spending it.

Check out this weekend's show March 11 and 12:

Forever Young:
We explore some of the controversial treatments in the thriving anti-aging industry.

Business Etiquette:
Tips to help you seal the deal or land your next job over lunch.

Tasty Travel:
Top vacation picks for food and wine enthusiasts.

Commuter Gadgets:
We review games and devices that keep you connected and entertained while on the go.

BusinessWeek weekend

Airs Saturday/Sunday nationwide.
Check your local listings
or view segments at
www.businessweekweekend.com

The Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A
Abbott (ABT) **14**
ABC (ABC) **24**
ABN Amro Veredus (AVEIX) **98**
Activision (ATVI) **54**
Adobe (ADBE) **46**
Advance/Newhouse **106**
Affiliated Computer (ACS) **50**
Allied Defense (ADG) **106**
Altria (MO) **52**
Amazon (AMZN) **18**
AMD (AMD) **28**
American Century **98**
American Express (AXP) **78**
AMR (AMR) **50**
Amylin (AMLN) **106**
Analog Devices (ADI) **96**
Apple (AAPL) **40**
Ariel Capital **90**
Arnold Worldwide **80**
AT&T (T) **28, 30, 32, 34, 106, 114, 116**
Atom Entertainment **20**
Audi **45**
Avaya (AV) **96**

B
Bank of America (BAC) **30, 96**
Barclay Group **43**
Beijing Dashihang Auto **45**
BellSouth (BLS) **28, 30, 34, 106, 114, 116**
Berkshire Hathaway (BRK) **28**
Bernstein Research **30**
BioTrainerUSA **104**
Blackstone Group **28**
BMW **45**
Boston Red Sox **43**
Brocade (BRCD) **14**
Bungie Studios (MSFT) **54**

C
Campbell-Ewald **80**
Campbell Soup (CPB) **28**
Canon (CAJ) **84**
CarrAmerica (CRE) **28**
CBS (CBS) **24**
CGM Focus (CGMFX) **98**
Charter (CHTR) **34**
Cingular **30, 106, 114, 116**
Cisco (CSCO) **50**
Citigroup (C) **78**
Coca-Cola (KO) **80**
Collins & Aikman (CKC) **28**
Comcast (CMCSA) **24, 30, 32, 3 116**
Comedy Central **20**
Corporate Library **96**
Credit Suisse (CSR) **106**
Crist Associates **78**
CSX (CSX) **86**

D, E
Dana (DCN) **28**
Delphi (DPHIQ) **28**
Deutsch **80**
DirecTV (DTV) **34, 114**
DuPont (DD) **50**
EchoStar (DISH) **114**
Education Management (EDMC) **28**
Electronic Arts (ERTS) **54**
Elevation Partners **54**
Eli Lilly (LLY) **106**
Elixir Pharmaceuticals **72**
EMI Group **20**
Enron **11, 28, 38**
Everest Asset **43**
Experian **104**

F, G
FedEx (FDX) **78, 88**
Fidelity **98**
Fresh Direct **40**
Friedman Billings Ramsey (FBR) **106**
Gartner (IT) **84**
GE (GE) **28, 78, 112**
Geely Automobiles **44**
Genentech (DNA) **70**
Gillette (PG) **114**
Gimme Credit **50**
GM (GM) **12, 28, 44, 45, 80**
Goldman (GS) **28, 30, 50**
Google (GOOG) **30, 116**
Griswold **11**

H
Hartford Financial (HIG) **78**
H.J. Heinz (HNZ) **28**
Honda (HMC) **44**
HP (HPQ) **28, 50**
Hyundai **44**

I, J
IBM (IBM) **14, 46, 50, 78, 84**
Institutional Shareholder Services **18**
Intel (INTC) **28**
Intrawest (IDR) **106**
iVillage (IVIL) **28**
James River Coal (JRCC) **106**
Janco Partners **106**
J.D. Power (MHP) **44**
JibJab Media **20**
John W. Henry **43**
JPMorgan Securities **50**

K, L
Kirshenbaum Bond **80**
Kraft Foods (KFT) **28, 52**
Krispy Kreme (KKD) **28**
Latex International **18**
Leo Burnett (PUB) **80**
Levi Strauss **78**
Littler Mendelson **40**
Loomis-Sayles **50**

M
Macromedia (ADBE) **22**
Mattel (MAT) **18, 78**
MBNA (BAC) **96**
McGraw-Hill (MHP) **44**
M.D.C. Holdings **96**
MedCath (MDTH) **18**
Mercer (MMC) **96**
Merck (MRK) **106**
Merrill Lynch (MER) **50**
Microsoft (MSFT) **11, 22, 28, 46, 54, 78**
Modernista! **80**
Monsanto (MON) **18**
Morgan Stanley (MS) **52**
Morningstar (MORN) **98**
Motorola (MOT) **50**
Movielink **24**

N, O
National A-1 **14**
NBC Universal **28**
Netflix (NFLX) **24**
Nissan (NSANY) **44**
Nokia (NOK) **28, 46**
NOW Broadband **18**
NTP **28**
Numi Tea **16**
NYSE (NYX) **11**
Oakmark **98**
Opera **46**
Oracle (ORCL) **46, 50**

P, Q
Palm (PALM) **28**
P&G (PG) **114**
Parks Associates **90**
PCCW **18**
Penguin (PSO) **28**
PeopleSoft (ORCL) **50**
PepsiCo (PEP) **40**
Pfizer (PFE) **64, 70, 96, 106**
Pharmacia (PFE) **70**
Pimco **98**
Pirate Capital **106**
Providence Equity **28**
Qwest (Q) **116**

R, S
Real Networks (RNW
Research In Motion (
28
Ricoh (RICOY) **84**
RS Investment **98**
Salomon Brothers (
S&P (MHP) **50, 54,**
Schering-Plough (S
Scientific-Atlanta (C
Shockwave.com **20**
Siebel (ORCL) **50**
Sirtris **72**
Skype **116**
Smith Barney (C) **9**
Sony (SNE) **12, 18,**
Spectrum Informati
Sprint Nextel (S) **30**
Staples (SPLS) **18**
Sun (SUNW) **46**
Suzuki (SZKMF) **28**
Symantec (SYMC)

T, U
Take-Two (TTWO) **5**
Taleo (TLEO) **40**
Target (TGT) **80**
Thomson (TOC) **28**
Time Warner (TWX
106
Time Warner Teleco
106
Tower (TWRAQ) **28**
Toyota (TM) **44, 4**
Trian Fund **28**
TVT Records **20**
UBS (UBS) **52**
Universal Studios
UST (UST) **88**

V, W
Verified Person **4**
Verizon (VZ) **28, 3**
vFinance (VFIN) **1**
Vodafone (VOD) **3**
Volkswagen **44, 4**
Vonage **116**
Wal-Mart (WMT)
Wendy's (WEN) **2**
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Xerox (XRX) **84**
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BusinessWeek

ARCHITECTURAL RECORD

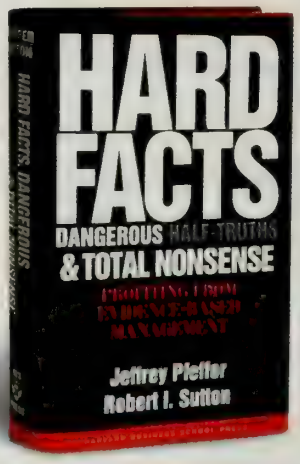
The McGraw-Hill Companies

Forget Going with Your Gut

HARD FACTS, DANGEROUS HALF-TRUTHS & TOTAL NONSENSE Profiting from Evidence-Based Management
By Jeffrey Pfeffer and Robert I. Sutton; Harvard Business School; 276pp; $27.50

For the average patient, the fact that "evidence-based medicine" is now one of the hottest forces in health care might seem pretty absurd. After all, isn't all medicine based on hard facts? Actually, no. To make decisions, many physicians rely on clinical experience, conventional wisdom passed down through training, and sometimes, outdated research. The evidence-based medicine movement, which has been gaining traction in hospitals and among insurers in recent years, calls for better integration of the most current, most carefully designed research into everyday medicine.

The practice of business management could use a similar movement, argue Jeffrey Pfeffer, a professor of organizational behavior at Stanford University's Graduate School of Business, and Robert I. Sutton, a professor of management and engineering at Stanford. In their densely researched book, *Hard Facts, Dangerous Half-Truths & Total Nonsense: Profiting from Evidence-Based Management*, the authors fret that managers' fondness for casual benchmarking ("GE does it? We should too!"), past practices, and pet ideologies may hold serious harm for their organizations.



The book is a rarity on the crowded management shelf. Unlike many such volumes, it offers no quick-fix, hype-heavy solutions from self-anointed gurus. At a time when intuition is on the ascent, thanks in part to Malcolm Gladwell and his best-selling *Blink*, *Hard Facts* is a useful reminder that the gut is often trumped by the facts. The book's deconstruction of some of the most widely applied management truisms and fads is thought-provoking but will leave some managers, especially those in metrics-driven cultures, unsatisfied.

The authors are at their best when dispelling the copycat tactics managers use for evaluating and rewarding talent. Take forced ranking, for instance. Popularized by General Electric Co. under Jack Welch, the process requires managers to divide employees into the top 20%, middle 70%, and bottom 10% of performers, often culling the lowest group. Practiced by as many as one-third of companies today, the authors say the approach has many flaws. A 2004 survey of more than 200 human-resource managers found that even though more than half of them used forced ranking, they felt it resulted in lower productivity, skepticism, reduced collaboration, and impaired morale. Breaking up teams by automatically firing the bottom 10% of workers can even be dangerous: Citing a National Transportation Safety Boar study, the authors note that 73% of commercial airline pi serious mistakes happen on crews' first day together.

Pfeffer and Sutton also make a surprisingly persuasive against paying widely divergent rewards to high and low performers, a popular practice in talent management too Many studies show that tying pay to performance can dr good results when individuals are working solo. But the can't be said for the collaborative, interconnected teams now make up most companies. The authors cite a 2005 s that surveyed senior management groups at 67 publicly traded firms. Those with greater gaps between the best- worst-paid executives also had weaker fina performance. Managers who implement w pay differences in heavily team-based grou argue Pfeffer and Sutton, forget that peopl a lot of fulfillment from their social bonds work, and creating such distinctions often diminishes trust.

At times, *Hard Facts* feels repetitive and borders on common sense. This is particu so in an early chapter on the intersection employees' work and personal lives. There evidence about why managers shouldn't b jerks, why they should encourage people t themselves, and why there are benefits to including family in company affairs. Do w really need to be persuaded?

Moreover, managers whose businesses p high value on metrics-base decision-making and on p testing of new programs n find some suggestions pai obvious: "It is also useful t in the habit of running sm experiments," for instance readers may at times feel l they're on the receiving en ponderous lecture: "Many companies and leaders sh little interest in subjecting business practices and de to the same scientific rigor would use for technical or medical issues. It is a pity."

> Managers need to rethink pet beliefs and add a shot of scientific rigor

But can managers really subject their decisions to the diligence as the medical field is seeking? Of course not. I blind, placebo-controlled studies aren't available in busi and fixing strategic dilemmas or personnel woes takes v different skills than treating a disease. In the end, *Hard* less about how to turn your company into a research-ba powerhouse than how to create a mind-set open to new research and resistant to conventional wisdom. ■

–By Jena M

SINGAPORE

LAND OF OPPORTUNITIES FOR GLOBAL BUSINESSES

Singapore has been consistently ranked as one of the world's most competitive and vibrant economies. It is a global entrepolis – a marketplace where innovation, business and capital converge and transact. It has all the right ingredients for businesses, whether big or small, established or new, to flourish. From its extensive reach of the world to its industry mix, pro-business mindset and sterling reputation for quality, reliability and efficiency, the more than 1,300 companies in Singapore today know they have a competitive edge.

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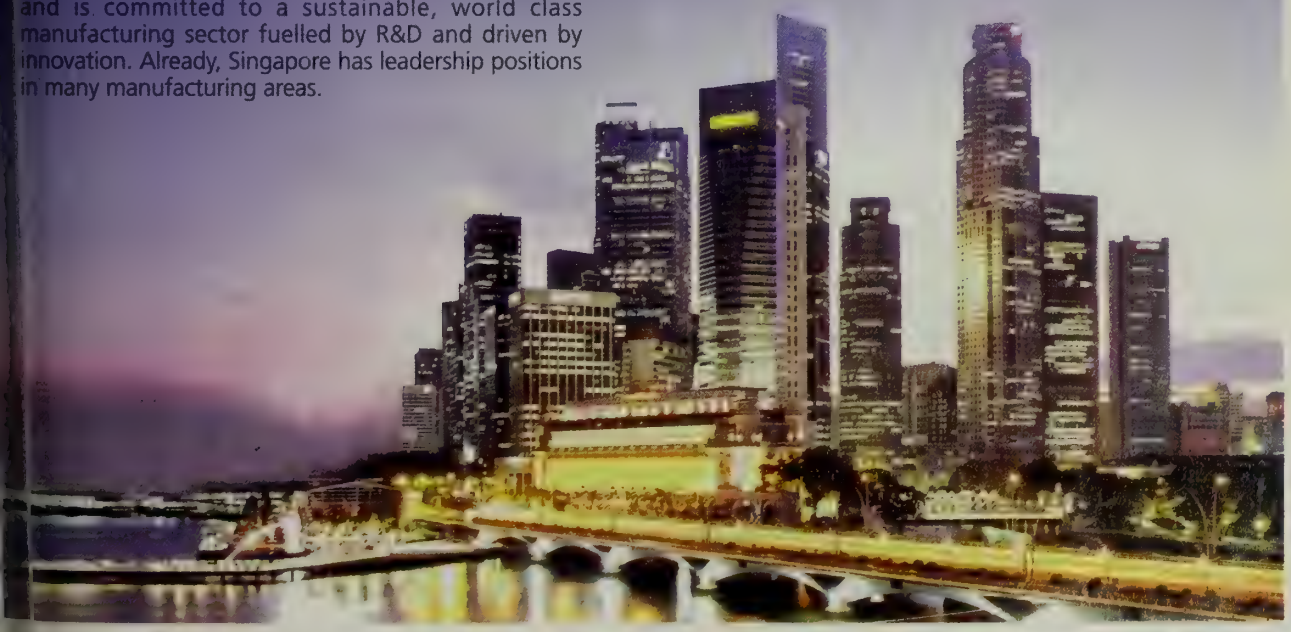
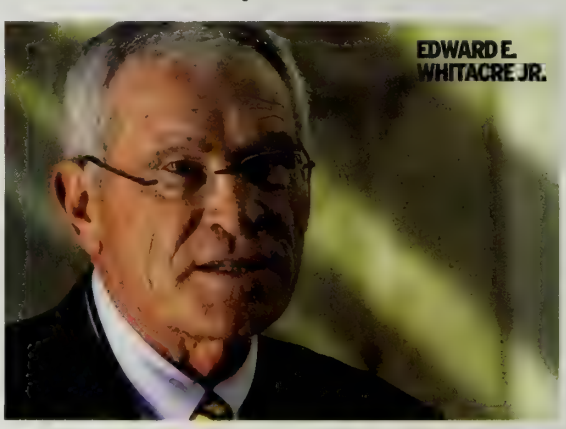


IdeasFaceTime
WITH MARIA BARTIROMO

Papa Bell Sure Seems Certain

ED WHITACRE WAS already known as a wheeler-dealer on Wall Street before he announced AT&T's $67 billion merger with BellSouth. And with good reason. He has been driving telecom consolidation for a decade, spending billions to piece together Ameritech, Pacific Telesis, and Southern New England Telecommunications. Just last year his renamed SBC Communications bought AT&T. Whitacre was set to retire in 2006 but will stay on until 2008 to lead the proposed AT&T-BellSouth colossus. I talked with him on the day the deal was disclosed.


EDWARD E. WHITACRE JR.

This deal seems like a defensive move—bulking up to battle the cable companies. Is that a fair assessment?
The world is changing rapidly, and we need a bigger footprint to be competitive. [Cable] is a very big competitor, and if you look at broadband, we are neck and neck. They are taking a lot of lines from us, and we need a counterstrategy. So from that standpoint, sure, you could say it's a defensive maneuver.

How did it happen? One report said you were duck hunting?
It happened over a long time. Mr. Ackerman [F. Duane Ackerman, CEO of BellSouth] and I are friends. We chatted from time to time, and a few months ago we just decided this was the time…to get the companies together. We didn't go duck hunting. There was no hunting involved. There was a meeting.

The last time we saw companies in your business spending billions to expand, the demand wasn't there, and the sector blew up.
There is demand to put wireline and wireless together. There is a huge demand. Who knows where the end is right now? What we will be able to do under just one brand is offer the consumers what they want. It doesn't matter if it's wireless service, video, or broadband. We can bundle them together. It's good news for the consumers because when you bundle, they get a better price.

Some people think prices will go up.
I don't think so. No way.

Are you worried about a regulatory roadblock?
You always worry, but…we are not taking a competitor the market. We're not putting the Bell System back toget

Do you expect more resistance than to the SBC-AT&T deal, the concerns about efforts to charge tolls on the Internet?
That's ridiculous. We have said publicly and to the SEC, n on the Internet changes. If we want to build more capaci people use, then they should pay for it. This is a false issue sumers will benefit.

How do you plan to approach th BellSouth partnership with Dir
AT&T has a partnership with Network. For the next year South will continue with Di and we will continue with Ecl [Then] we will have to figure

Would it make sense for AT&T eventually acquire Echostar?
I won't comment on that.

Let's talk price. Did you overp
I don't think so. It's in the r premiums being paid f deals…in line with the P&G deal [Procter & Gamble pai billion for Gillette last October].

Some people were surprised at your timing, because you lot to digest. You are still integrating SBC and AT&T and, s might say, Cingular and AT&T Wireless.
Cingular is run by separate management, so no integra sue there. BellSouth is a telephone company, and we ar phone company…we know the phone business. I don there will be any integration issues at all.

You became CEO of the former Southwestern Bell, the sm of the Baby Bells, in 1990 and have been a driving force b wave of consolidation in the telecom sector. Are you don
We have our plate full and a good strategy that we will well. We will be in the wireless business, the Internet T ness…we've covered the waterfront. ■

Maria Bartiromo is the host of CNBC's Closing Bell.

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BY LEO HINDERY JR.

Watch This Hookup Closely

Who says you can't put Humpty Dumpty together again? With AT&T's acquisition of BellSouth, Ma Bell will (almost) be back (page 30). The stated justifications for this huge new merger are to save $2 billion a yea in expenses on a $120 billion combined revenue base and, says Chief Executive Edward E. Whitacre Jr., to enable the combined company to "have more products, better services, and better prices."

Unfortunately, neither justification is likely to pan out, and there is not one product or service that AT&T will have with BellSouth that it could not have had without it. Not one. So the only real advantages from this merger for AT&T shareholders are a clarified management structure at the two companies' Cingular cellular joint venture and probably slightly faster rollout of wireless Internet calling. Those two changes are certainly important, but they're not nearly desirable enough to allow this merger to proceed without regulators imposing some very tough conditions.

I'm so skeptical because every time a major cable-systems merger was proposed in the past, the justifications were essentially the same: modest cost savings that would fuel more services and better prices for consumers. But those never materialized. Why not? Once a telco or major cable company has achieved scale, and they all have by now, these purported justifications become ludicrous, especially when (as with AT&T and BellSouth) there is little or no preexisting overlap of their service areas.

AS A BUSINESSMAN and former cable operator, I can appreciate Mr. Whitacre's desire to bulk up to better compete in both traditional telephony and newer growth areas like broadband video distribution. Not only is he battling stiff competition in voice-over-Internet telephony from the likes of Vonage, Google, and Skype, but he also faces an array of newer delivery technologies such as Wi-Fi, WiMAX, and broadband over power lines. Then there are the major cable companies, which are deeply entrenched in video distribution and have the huge advantage of vertically owning much (in fact, way too much) of the nation's programming.

But the telcos and cable already have virtual strangleholds over wire-line access. (A combined AT&T and BellSouth would control 71 million local phone customers in 22 states.) So this proposed megamerger will be devastating for consumers unless some strong limitations are put on the merged company in two areas: bundling and pricing practices and "Internet neutrality."

Indeed, with broadband soon to be AT&T's (and all ot significant distributors') major offering, the Bush Administration and the Federal Communications Commission must stand up for consumers and insist th AT&T, Verizon, Qwest, and cable operators not layer on their broadband services unreasonable user surcharges "speed controls" that favor one service provider over an Such acts would crimp consumers' access to the Net an distributors unwarranted monopoly-like profits and con

> Without strong limits, the AT&T-BellSouth merger will be bad for consumers

Likewise, regulators must restrict discrimi bundling and predatory pricing, which lim consumer choice, in both services and con

That's not to say that regulators should down only on telcos. Washington should g AT&T, Verizon, and Qwest nationwide vide transmission rights so they can compete s and better with cable in video distribution it must end the vice grip of vertical integra that allows programming owned by a dist (especially cable operators) to be treated n favorably than independent programming vertical integration, when abused, is a fra consumers and an impediment to compet It needs to be restrained, and Mr. Whitacr should demand that as a quid pro quo for limits that are sure to be imposed on his proposed deal.

So let Mr. Whitacre have his merger—heck, the Administration and the FCC let Comcast acquire AT&T Broadband in 2002 without blinking an eye. But let's h him to his promise of "more products, better services, a better prices." Given the grave potential for abuse to consumers by those with quasi-monopoly power, the Administration, the FCC, and Congress must impose appropriate restrictions on the AT&T-BellSouth merge

Leo Hindery Jr., *managing partner of InterMedia Partn former CEO of Tele-Communications Inc. (TCI), its succes AT&T Broadband, and the YES Network.*

Views expressed in Outside Shot are solely those of contributors.

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IS YOUR COMPANY FAST ENOUGH?

Speed-to-market is now the ultimate competitive weapon. Lessons from the companies that are racing ahead

BY STEVE HAMM (P.68)

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BusinessWeek

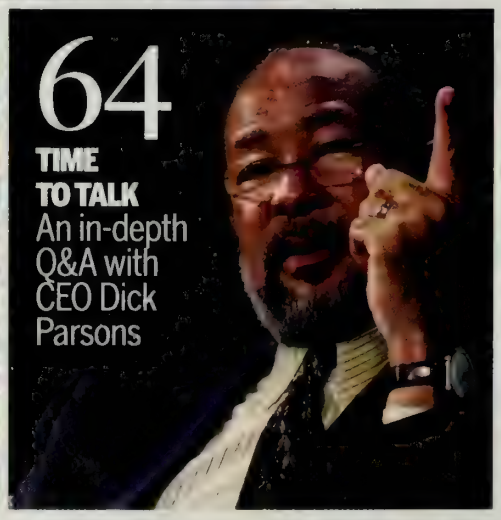
March 27, 2006

68

QUICK AND THE DEAD
In the Internet Age, it's the survival of the fleetest. Which companies are setting the pace, and how?

32

SKILLS GAP
Why China faces a labor crunch



64

TIME TO TALK
An in-depth Q&A with CEO Dick Parsons

Cover Story

68 Speed Demons
Companies can create products—and busines —almost overnight. Sp is now the ultimate competitive weapon. In everything from retail t medical devices, the tin takes to bring a produc market has been cut in half. Competition is eve more intense, and it's being driven by the rise Asian powerhouses an spread of Net technolo

70 H&M: It's the Latest Thing
When the retailer designs a new o can get a plant rolling in days—or

72 Programming at Warp Speed
At 37signals, the rule is keep prog simple and move them quickly

74 Team Is of the Essence
How XM Satellite and Samsung n their strengths

76 Breaking out of Commodity He
Best Buy did it by segmenting cust

The Business Wee

30 News You Need to Know
Goldman's gold mine; a new bid GMAC; Knight Ridder's future; n

News: Analysis & Commentary

32 China: Rising Wages Change th
A labor shortage has pay soaring sure to send ripples around the g

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er about the Web
panies become more savvy about where to place their online ing, the Internet will see a flight y

ning In on TV Eyeballs
aim to give advertisers a much ea of who's watching what

54
BEYOND CLICKS
In online ads, it's all about counting the eyeballs. Better ratings tools are creating an Internet elite

Media

64 Dick Parsons on the Record
With the Icahn battle won, Parsons talks about Time Warner's stock—and his own future

People

78 Hank at War
One year after he was forced out of AIG, Greenberg is still smarting. But his battle has only begun

Entrepreneurs

84 An Arty Niche
It's been a banner year for the Weisers, who collect and sell the wall-size panels used to advertise museum exhibits

Social Issues

86 A Body Blow to Illegal Labor?
Court rulings and legislation could change the game for companies such as Mohawk Industries

Personal Business

96 Beyond the Annual Physical
How much do you want to know about your health? For well-heeled worriers, the sky's the limit

98 Cameras without the Shakes
A guide to the new image-stabilizing compacts—a boon for the casual shooter

102 An ETF for Every Angle
Niche funds to diversify your portfolio

104 Where to Go for Growth
A survey of 1,700 companies finds seven primed for a growth-stock comeback

108 Personal Business Plus
Branding Canyon Ranch; Audubon bird prints; new tea-flavored twist on gin; shape-shifting backpack

Columnists

19 Wildstrom: Technology & You
Biting into two juicy new Apples—the first with Intel inside

24 Fine: Media Centric
McClatchy moves to the majors as it bets against the newspaper slump

27 Cooper: Business Outlook
Bond yields are higher—and it's about time, too
Construction: A teardown in jobs?

110 Marcial: Inside Wall Street

122 Jack and Suzy Welch: The Welch Way
Money isn't the only way to light a fire. Here are four smart ways to motivate your people

Ideas

120 Books
Flannery: *The Weather Makers*
Kolbert: *Field Notes from a Catastrophe*

124 Outside Shot: Richard G. Lugar
The oilman in the Oval Office is the ideal advocate for developing alternative energy sources

Features

9 UpFront
14 Readers Report
16 Corrections & Clarifications
112 Figures of the Week
119 Index of Companies

Center for Companies That Care
announces the
2006 Companies That Care Honor Roll
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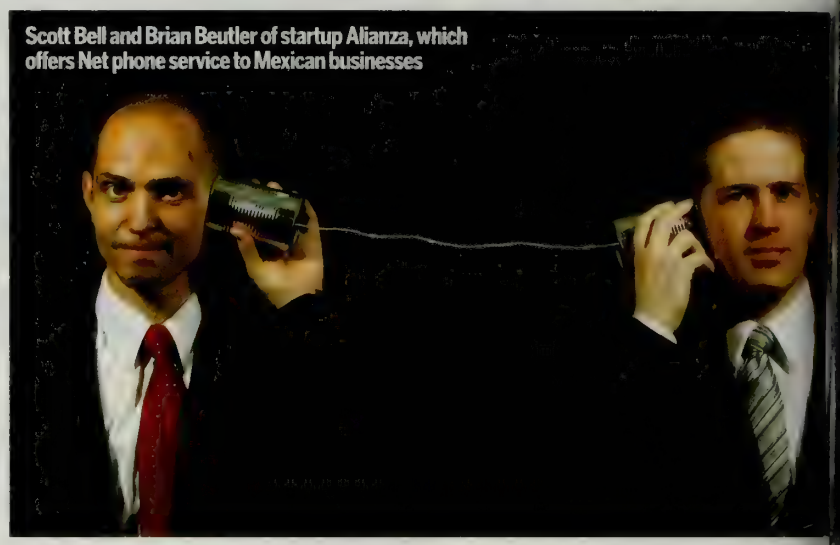
Scott Bell and Brian Beutler of startup Alianza, which offers Net phone service to Mexican businesses

Meet the Young Entrepreneurs of Tech

Dozens of Internet startups are bringing increased capabilit to Web sites, inspiring **a new boom** in tech investment, buyou and mergers. As a result, a fresh bumper crop of entreprene is coming to the fore. Our **Online Special Report** takes a close look at the latest innovations, the impact they're having on established media companies, and some of the young minds behind them. For example, a profile of Angus Davis, co-founder of what may be the year's hottest IPO, Web **telecom startup Tellme,** tells of his transition from prep school prankster to the creator of a company that brings Web search capabilities to telephones. We also survey the country's top venture capitalists to compile a short list of tech's most **pron new players** and profile winners of business plan competition at top universities. Rounding out our report is an interview with **Frank Moss,** the newly appointed head of MIT's influent Media Lab. For news, analysis, slide shows, and more go to **www.businessweek.com/go/youngtech06**

Tellme's Angus Davis

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UP Front

"These states will bend over backwards to give them the farm–and the land the old farm was on."

–Kim Hill of the Center for Automotive Research, on incentives Southern states give to carmakers like Kia Motors, which will build its first U.S. plant in Georgia, as reported by The Washington Post

D BY DEBORAH STEAD

SCHOOL

IY BIZ BACKS HS TAX HIKE THE RICH

NOT SOUND like an item op of the corporate t. But both the **Los** and **San Francisco rs of Comm-** supporting ative on the ia ballot to rich and free, ry public ol for all the -year-olds. osition 82, ecently got ,000 signa- eded to put it on the lot, would raise $2.4 year from a 1.7% n incomes of the State's richest 1%— als earning more than 0 and couples making more than $800,000. Says Los Angeles Chamber CEO Russell Hammer: "California is underachieving in education, so we decided not to take a knee-jerk reaction to a tax hike." Studies show that kids who attend preschool—especially those from low-income families—are less likely to drop out of high school.

Despite business backing, the proposal faces an uphill climb in the land of Prop 13. Anti-tax groups complain that the initiative subsidizes middle-class families who can afford preschool on their own. If it passes, Prop 82 will make California the latest to join a "universal preschool" movement. Florida, Georgia, and Oklahoma offer preschool classes to all 4-year-olds.

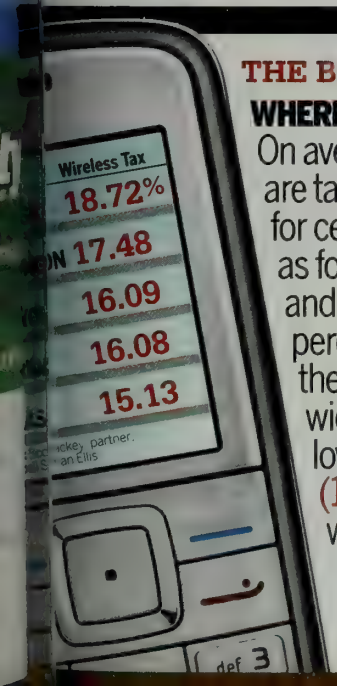
–Aaron Bernstein

HEALTH CARE

Equally Lousy Treatment for All

IN A REPORT that gives new meaning to the term "universal health care," a **RAND** study concludes that all Americans—including the well-heeled and the well-insured—get lousy medical treatment. Published in the Mar. 16 issue of ***The New England Journal of Medicine,*** the study—part of the largest ever to look at quality of care—shows that people receive only 55% of the treatments they require. The report doesn't contradict earlier studies showing that minorities, the poor, and the uninsured have less medical access. It measures the quality of care given to those who get in the door. On that scale, families with incomes over $50,000 scored a measly 3 to 5 percentage points higher than those with incomes below $15,000. The insured vs. the uninsured? No difference. The study, funded by the **Robert Wood Johnson Foundation,** analyzed care given to 7,000 patients in 12 cities from 1996 to 2000. Scores were based on 439 quality indicators for 30 acute and chronic conditions. Preventive care also was assessed. Says Dr. Steven M. Asch, associate research chief for the Veterans Affairs Greater Los Angeles Health Care System and the study's lead author: "Everyone is equally at risk for receiving poor quality of care. No place is safe, and no one is safe."

–Catherine Arnst



THE BIG PICTURE

WHERE TALK AIN'T CHEAP

On average, Americans are taxed at twice the rate for cell-phone service as for other goods and services. The percentage added to the bill, which varies widely by state, is lowest in Nevada (1.09%). Here's where it's highest.

–Bremen Leak

UPFront

SIDE EFFECTS

SLEEPLESS NIGHTS FOR DRUGMAKERS

THE PAST FEW weeks have been anything but restful for the makers of sleep-inducing drugs. **Sanofi-Aventis'** Ambien has come under attack for

prompting some patients to eat in their sleep, or worse, sleepwalk to their cars and cause bizarre traffic accidents. A quieter campaign has been building against rival **Sepracor's** new drug, Lunesta. In Internet chat rooms, patients gripe about a bitter aftertaste that goes way beyond the "unpleasant" effect mentioned on the label. "Lunesta tastes like a herd of wild animals nested in my mouth," reads one post. Nancy Munroe of Florida, who has taken Lunesta since its launch last year, says: "I've never tasted urine, but I could imagine it would taste something like that."

Lunesta's label says that 17% to 34% of patients in a six-week trial suffered from the side effect. The company declined to comment. A Sanofi spokeswoman said via e-mail that "although sleepwalking may occur," it may not be caused by Ambien. There's a lot at stake. Last year Ambien sales rose 11%, to $1.8 billion. Lunesta brought in $329.2 million in its first few months. With **Pfizer** readying a sleep pill for later this year, these drugmakers have even more reason to lose sleep. *–Helena Oh and Arlene Weintraub*

MOVE OVER, VEGAS

THE CHINESE ENCLAVE of Macau—an hou ferry ride from Hong Kong and easily reach from China's other affluent coastal cities—soon displace Las Vegas as the world gam capital. Gaming revenues rose 11% last ye $5.5 billion. "By 2008 or 2009, we are talk about an $8 billion to $10 billion market," Grant Bowie, president of Wynn Resorts (Macau). Vegas, now at roughly $6 billion, expecting that kind of growth. Wynn, which open a $1.2 billion casino this fall, is just o the big gaming companies flocking to Mac The draw: high rollers. Average daily take gaming table is $8,500, almost three time higher than in Vegas. *–Frederik B*

BLOGSPOTTING

TRACKING THE PORTS STORM

Globalvoicesonline.org

» **WHY READ IT:** Backed by Harvard Law's Berkman Center for Internet & Society, it tracks news blogs globally.

» **NOTABLE POST:** Moroccan blogger Jawad's take on the Dubai Ports World flap: "Globalization is not the sole property of American enterprise. It is called 'globalization' for a reason—it is why a government-owned Spanish company (Aena) is managing several airports in Mexico; why private foreign companies control some 45% of Algeria's crude oil production; and why private Indian firms are competing for major stakes in the U.S. software industry."

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UP Front

PILL PUSHERS

REP OF A (DRUG) SALESMAN

When it comes to pitching drugs to doctors, the thinking goes, the best sales reps are those who are best liked by physicians. That's why Big Pharma closely follows surveys that ask physicians to rate rep effectiveness. Last year just such a poll from GfK Market Measures put Pfizer and Merck on top.

But popularity may not be the point. TargetRx, a consulting firm co-founded by a former Merck executive, Michael Luby, claims it can identify what really makes a sales rep effective. For the past six years, Luby has conducted his own surveys of physicians, using a computer program that links responses to actual prescribing habits. The results: In marketing to primary-care doctors, Abbott Laboratories reps have the most impact; Pfizer and Merck reps rank seventh and eighth, respectively. Some key factors that move a pitch onto the prescription pad: good written material and the ability to describe a drug's target patient. *–Amy Barrett*

WIRED LIFE

A NEW STOP BEFORE YOU TAKE OFF

SURF THE WEB for vacation spots this summer, and you're likely to encounter an alternative route: a dot-travel domain in addition to the usual dot-com or dot-net. The new domain became a dot on the e-map last fall after getting the go-ahead from the **Internet Corporation for Assigned Names & Numbers,** the nonprofit group that coordinates Internet addresses worldwide.

Ronald Andruff, CEO of **Tralliance,** which oversees the selling of names in the new domain and maintains a registry, says a dot-travel Internet address will signal both authenticity and convenience. Now, consumers looking for "Paris vacation" get back millions of hits, including many repeats. Tralliance checks the credentials of the travel and tourism outfits it registers to be sure they are bona fide groups with rights to the names they wish to use. All of the new domain's Web sites will be listed at www.directory.travel.

Some tourism groups, such as the **Travel Industry Assn.,** won't add or move to a dot-travel address right away. "Dot-com and dot-org seem to work fine," says TIA spokesperson Cathy Keefe.

But heavy hitters such as **British Airways, Disney,** and the state tourism boards of Utah and Florida have already signed on. The **Canadian Tourism Commission** will make Canada.travel its prim site this spring. Trallia says about 21,000 dot- domain names have be sold since October, at $ $250 a year (compare $8 to $35 annually for com domain names).

Will consumers kee Google searches for "F resorts" when they car in "Florida.travel" ins For the time being, Da chief marketing office Florida's tourism arm, Florida, is betting on b domains. "Dot-com is an established standar says. "Nobody can pre how consumers will r *–Elizabet*

REWIND

HEDGE FUNDS GET CLIPPED BY THE SEC

CONVOLUTED FINANCING schemes are catching up with some hedge fund managers. The latest example: On Mar. 14 three hedge funds and their portfolio manager, Jeffrey Thorp, agreed to pay the Securities & Exchange Commission $15.8 million to settle fraud and insider trading charges in connection with 23 deals involving private investments in public equities, or PIPEs. The SEC says Thorp and the funds—Langely Partners, North Olmsted Partners, and Quantico Partners—made more than $7 million in illicit profits from 2000 to 2002. Thorp allegedly used unregistered shares obtained in the private placements to cover short positions, a violation of federal securit laws. The defendants settled without admitt denying wrongdoing.

The case also is the latest sign that regula are cracking down on hedge fund abuses of nonpublic information ("More heat on hedg BW—Feb. 6). Thorp allegedly traded seven s advance of the public announce their private sale. "We've bee devoting substantial resour investigations involving u trading practices by hed and others in PIPEs deal including cases involvin insider trading and othe deceptive trading sche says Scott Friestad, an associate director at the Enforcement Div. "We're determined to...deter oth from engaging in these pr *–Am*

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"I can only applaud Home Depot's military-style management and Robert Nardelli. What's missing is focus on the customers."

–George F. Steeg
Potomac Falls, Va.

HOME DEPOT: STRONG FEELINGS FROM FRIENDS AND FOES

Our Mar. 6 Cover Story, "Renovating Home Depot," took a close look at the corporate culture that Chief Executive Robert L. Nardelli is trying to build—one that's based in part on military concepts and personnel. We argued that the command-and-control discipline Nardelli has imposed is getting financial results. But a deluge of letters, online posts, and message board responses—nearly 300 in all—indicates the overhaul has come at a cost. Many readers connected the military-style ethic promoted by Nardelli to a decline in customer service at Home Depot stores. In a startlingly similar refrain, they complained of indifferent workers, long lines, and unpleasant stores. Only two correspondents praised America's largest home supply store. What follows is a sampling of reader reaction, with a reply from Home Depot.

The Customers Vent

AS A SUBMARINE Navy veteran, as well as a General Electric veteran (Heavy Military Electronics), I can only applaud Home Depot's military-style management and Robert Nardelli. What's missing is focus on the customers. I'm also a veteran home improver. I've watched Home Depot under Nardelli follow in the footst Northern Virginia's now-defunct inger stores, while Lowe's eats Ho pot's lunch.

The first problem at Home Dep Nardelli's arrival was extensive vi of Carl Liebert's "Customers cann what we do not have" slogan. Home Depot first appeared on the before Nardelli, it corrected two f problems that were Hechinger's un out-of-stock items, poor display of e stock, and floor employees' lack of siveness to customers. Home Dep fore Nardelli, was fully stocked an people in the trade who were avail force on the floor. They understo stock and could help customers us

Many of us now find broader an complete stock, along with bett availability and knowledge, at L go more than an extra mile to s cordingly. Home Depot would do change its focus from comma control to customers.

–George
Potomac F

GROSS SALES at Home Depot soaring, but the customer service

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ReadersReport

just gross. For example, Home Depot stores have lots of checkout lanes, but often most of them are closed, and they attempt to push customers to the awful self-checkout area. I wrote a letter to Home Depot corporate and told them I did not wish to become their unpaid employee, even for five minutes.

–Jeffrey E. Schmidt
Kissimmee, Fla.

I APPLAUD CEO Bob Nardelli's efforts to make the shopping experience consistent throughout each store. He has brought order to what was at times an experience in futility trying to find a particular item. Unfortunately, it provides me the speed and efficiency I crave for all the wrong reasons—to get in and out of the place as quickly as I can so that I don't have to hear the workers gripe about yet another change being implemented by senior management.

–Scott Haines
Foster City, Calif.

I SEARCHED "Renovating Home Depot" in vain for some reference to military veterans' value as employees—besides their maturity, discipline, and a willingness to relocate to unsavory locales.

The veteran employee's ability to "think on his feet" was praised, but the critical plans are now being made by Home Depot central management. I read no reference to how the plans are developed—for example, how those target sales numbers (nervously tracked by store managers on their BlackBerrys) are defined. What thinking is the veteran employee empowered to do?

Similarly, Home Depot has responded to its "strategic" needs by replacing its seasoned, well-compensated professional staff with a vast crew of business personnel who will be willing to accept more demands and question authority less. It seems that decisions are being made strictly on the basis of numbers, often without a sense of their root cause or interconnected nature.

–Jennifer Kirley
(Formerly HT1 Hull Maintenance Technician First Class, U.S. Navy)
Greene, Me.

I RECENTLY VISITED Home Depot to buy a simple polyvinyl chloride (PVC) elbow for my sprinkler system, something that probably would cost less than a dollar. After spending an inordinate amount of time just looking for the item, I went to the front of the store only to be greeted by one clerk and two checkout lines, 10 to 12 people deep. It wasn't worth the wait. Shop again at Home Depot? Never.

–Larry Paquette
Fresno, Calif.

AFTER READING the Cover Story, I have to say I am a Nardelli supporter. Having experience in the Marine Corps during Vietnam and also as a manager of 1,000 people in business, I see great parallels for success. Most successful businesses require balanced performance—financial, operational (or process improvement), customer focus, and developing people. To deem this militaristic when it is just good business is a bit naive. In today's all-volunteer military, there is much more focus on balanced performance and people skills, as opposed to the blood-and-guts perception created by Hollywood. To keep the volunteers, the military has actually improved more quickly than some U.S. businesses. To hire people who are well-trained is an excellent strategic advantage for which I commend Mr. Nardelli.

–Richard Jozwiakowski
Round Rock, Tex.

Home Depot Responds

WITH 1.3 BILLION transactions a year, we're bound to make mistakes, but nothing disappoints us more than letting down a customer. We're making continuous improvements in our customer service levels and are working harder than ever to make sure that our service delivery meets the high expectations our customers have of Home Depot.

–Jose Lopez
Senior Vice-President
Chief Customer Officer
Home Depot
Atlanta

A MODEL OF BUSINESS INTEGRITY

"LEGAL TANGLE at the fountain of youth" (Cover Story sidebar, Mar. 20) suggests that during his time leading the former Pharmacia Corp., our Chairman and CEO, Fred Hassan, may have been aware of improper promotion of a growth hormone product through a longevity center. This insinuation is apparently based on a few words scribbled at the top of an unsolicited letter from such a center, in which Fred requests staffers to follow up and acknowledge the correspondence.

I can tell you from my experience that Fred is an executive who directs this kind of action on dozens of documents a day. He is particularly diligent in striving to assure that every piece of external communication to him gets an appropriate response. I think this is admirable; tion that these routine notation some signal to others to do sometl appropriate I find incredible.

Fred is a CEO who through his al behavior has become a leade business world when it comes to b integrity. Indeed, that is why I lef er satisfying job to join Fred's n ment team at Schering-Plough, w have installed a business integr gram that is widely studied as a n its kind. With Fred, integrity is words, it is actions. So it is especi fortunate that *BusinessWeek* has n en space to these flimsy allegatio

–Brent S
Senior Vice-Pres
Global Compliance & Business
Schering-Plou
Kenilwo

CORRECTIONS & CLARIFICATIO

In "Follow my money" (Personal Busi Mar. 6), Makelovenotdebt.com blogge have $154,020.99 in debt, not $98,61

In "Is the MBA overrated?" (B-School 20), the name of a Hartford Financial Services Group executive was misspe The correct spelling is David K. Zwien

In a table accompanying "China, savi the Rust Belt?" (Government, Mar. 13 saying used to express Chinese inves caution was misquoted. The correct is: "The Chinese cross the stream by the stones first."

In "Battling for the eyes of Texas" (Ne Analysis & Commentary, Mar. 20), Ve TV service in Keller, Tex., downloads a 5 or 15 megabits a second, not megal

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Technology&You

BY STEPHEN H. WILDSTROM

wo Juicy New Apples

esign innovations go, MagSafe isn't a big deal. It replaces the standard er cord socket on Apple Computer's new MacBook Pro laptop. With old design, you'd send the computer flying if you tripped over the cord. Safe is a nifty magnetic connector that simply breaks away. History s won't celebrate this invention, but it's an example of the smart touches

tinguish Apple in an where design is all icing a buck off of of materials. ew MacBook (from is the successor to ch PowerBook G4 and is Apple's first k to use an Intel Core Duo r. While the insides are all new, pt the PowerBook's very ul, three-year-old design essentially ed. Two more Intel-driven PowerBooks are to follow, one large and one small. ntel processor makes a big difference in tops, more so than for the new iMac s, which I reviewed on Feb. 13. That's because the he old PowerBook was a full generation out of date. e MacBook Pro is running programs written for the ps, you get an impressive speed increase—though it rt of the 300% gain claimed by Apple. As for the older grams, they all run perfectly well, but the user won't improvement.

INSIDE: The Intel Core Duo processor brings zip to MacBook

DRIVE THE MacBook Pro, I ran a piece of free software andBrake that converts the video on a DVD so that view it on a video iPod, an extremely processor- task. HandBrake is one of a new breed of al" programs that can run on both old and new nverting 16½ minutes of recorded video took 22 on PowerMac G4 and just nine on the new MacBook. t get boosts like that in reading e-mail or browsing but you will see real gains in tasks such as photo g and video editing.

has managed to go on selling PowerBooks even as formance fell further behind in the Windows ion. One reason may be the company's ability to with customers on an emotional level. The camera the new MacBook is a good example of how Apple functional and fun. Used with the built-in iChat these turn a Mac into an instant and very good encing device. When you first set up your user you are invited to take a picture of yourself and use it as your login icon. Now try the same thing on a Windows PC. It's a taxing, six-step process, assuming the picture is already saved on your PC.

The new Mac mini (from $595), a desktop not much bigger than a fat paperback book, also runs on Intel now, and it has handy new tricks. It has a selection of video connectors and Front Row software that make it simple to show videos and photos and play music on a TV/stereo system. It comes with excellent networking technology called Bonjour that can find and play content stored on other computers—even Windows PCs, if the content is stored in an iTunes library.

MacBook and mini please the eye, the brain, and the budget

There are good reasons competitors such as Dell and Hewlett-Packard have a tough time keeping up with Apple. One is Apple's rejection of rock-bottom pricing. Desire for big orders from low-end retailers such as Wal-Mart has pushed HP and other PC makers to adopt the cheapest hardware platform, leading to $300 desktops and $700 laptops. There's no way to hit that price point and match Apple on design. What's more, PC makers sell to corporations, which insist on the ability to replace components easily. Apple's beautiful design doesn't allow that, and home users don't care.

Apple has thus turned its lack of access to corporate markets into a virtue. It can focus its energies on what appeals to consumers, especially ease of use and products that please the heart and the eye as well as the brain and the budget. The new mini and the MacBook are just the latest happy examples. ■

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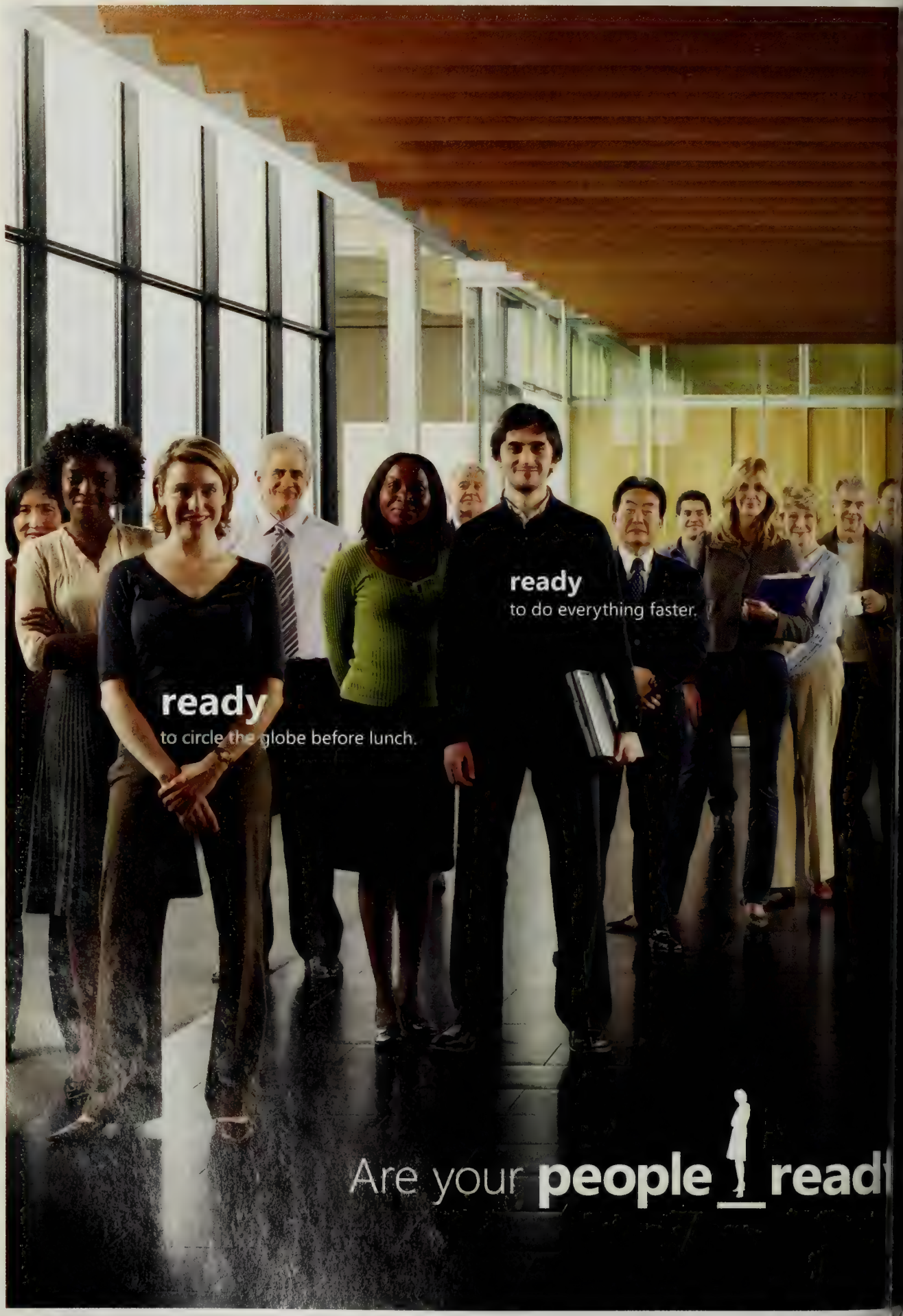
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IAMES C. COOPER

Bond Yields Are Up --And It's About Time, Too

h overseas liquidity diminishing, rates must rise to attract foreign funds

U.S. ECONOMY It took a long time, but the bond market finally may getting religion. Market players are starting to believe that the U.S. nomy is stronger than they had thought and that the Federal erve will be lifting short-term interest rates by more than they had ected. Now, central bankers overseas are starting to preach a r message of economic improvement and tighter ary policy. As a result, bond brethren have sent recently to two-year highs. Yields on 10-year ry notes have been hovering at or above 4.7% for of March, up from 4.1% six months ago. That rise is rket equivalent of a loud "amen."

upward climb in bond yields most likely has to go. First, the economy is showing few signs of g in a way that will relieve concerns about future n. Second, without those signs, the Fed will be ing to risk a pause in its rate hikes, especially he strength of the labor markets in February, signals robust job growth and a further ation in wage increases.

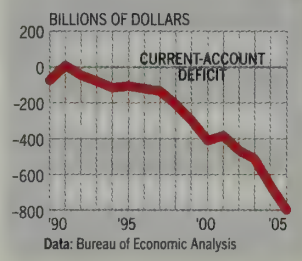
d, and perhaps most important, global financial ons are beginning to shift. With the European Bank (ECB) raising rates and the Bank of Japan n the road to tighter policy, the days of excess global y are ending. That means less global savings will way into U.S. Treasuries, reversing a trend that has to keep yields low. And fourth, improving growth estment prospects abroad will put new downward e on the dollar. As a result, foreigners may require yields before they are willing to hold U.S. bonds.

HANGING GLOBAL ENVIRONMENT is the element in the bond market outlook. In recent asy monetary policies in the euro zone, Japan, and ave created an enormous amount of liquidity for a place to be invested. The rise of global markets has meant that U.S. Treasuries have often up those excess funds, since investment nities outside the U.S. have been relatively ctive. That trend has helped to support the dollar p bond yields low.

global liquidity is ever-so-gradually being d by tighter policies abroad. The ECB has hiked y rate from a record low of 2% last year to 2.5% 2, and economists expect further increases, it to at least 3% before yearend.

over, any further move by China to lift the value rrency would be a de facto tightening of its y policy. On Mar. 15 the yuan posted the largest one-day rise vis-à-vis the dollar since China's revaluation in July of last year. A move that big suggests increasing flexibility on the part of China to allow its currency to fluctuate. Economic pressures clearly favor a move up, as does steady political pressure from both the U.S. and Europe. Indeed, the pace of the yuan's rise appears to have picked up somewhat in the past two months.

THE GROWING BURDEN ON U.S. FINANCING



Data: Bureau of Economic Analysis

In Japan the BOJ is a long way from hiking interest rates, but it has begun to tighten policy. On Mar. 9 it ended its five-year policy of "quantitative easing." Having already lowered interest rates to zero with no economic response, the BOJ had taken the unconventional step of flooding the banking system with reserves to kick-start lending and the economy and to reverse the process of deflation. With that accomplished, it is now starting to rein in the excess money, and it is expected to begin lifting rates off zero later this year.

THE INVESTMENT PATTERNS of foreigners are likely to change in the coming year, including moves to diversify away from U.S. assets. Last year, for example, net purchases of U.S. Treasuries by foreigners slipped to $281 billion from $380 billion in 2004, according to the tally of international transactions by the Bureau of Economic Analysis. Most of that slippage appears to have been in short-maturity instruments, but last year was the first since 2000 that inflows to Treasuries were less than in the prior year. Any further shift in investment flows could have big implications for both the bond market and the dollar, given America's mammoth financing needs.

Those needs are illustrated by last quarter's current account deficit, the broadest gauge of U.S. international transactions (chart). The gap, composed mainly of the trade deficit, increased to a record $224.9 billion in the fourth quarter, equivalent to 7% of gross domestic

product. For the full year the deficit swelled by $136.8 billion to $804.9 billion, or 6.4% of GDP. That means the U.S. had to attract some $67 billion every month in foreign capital to fund the deficit. Economists expect the financing needs to grow further in 2006.

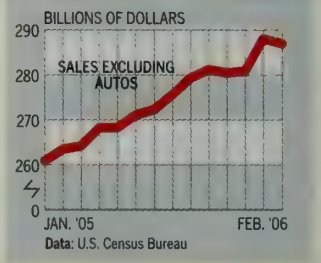
The U.S. will continue to attract the foreign financing it needs. The question is: At what dollar and interest rate levels? It's the dollar that will equilibrate the financing needs of the U.S. with the willingness of foreigners to supply them. The dollar will most likely decline further, as competition for global funds increases.

FOR NOW, THE BIGGEST FACTOR in the bond market's prospects is the strength of the economy. With the first-quarter growth surprise playing out as expected, bond players will breathe a sigh of relief only if they see concrete signs that the economy is cooling in the second quarter. So far, that's no sure bet. The only clear indications of softer growth are in housing, but other sectors have solid supports for future growth.

On Mar. 14 bonds took heart from February's 1.3% drop in retail sales from January, as the 10-year yield fell sharply. But the sales decline was hardly a sign of weakness (chart). It followed January's 2.9% surge, the result of that month's record warm temperatures, which generated some buying that might normally have occurred in February. Taken together, so as to even out the weather effects, sales averaged 0.8% per month, well above the 0.5% average gain during all of 2005.

Both consumer buying and capital spending by businesses have strong underpinnings. February payrolls rose by 243,000, with gains in the first two months of 2006 averaging 207,000, a speedup from 167,000 average in the second half of 2005. Plus, household net worth posted a sizable gain in the fou quarter, according to the Fed's latest data. Company balance sheets look more impressive.

NOT MUCH WEAKNESS IN RETAIL SALES



Data: U.S. Census Bureau

Foreign demand another support, as economies overseas up. Exports through January grew at the fastest four-month in more than 11 yea Both exports and imports posted big in January, resultin record trade deficit, the data imply that demand, both at home and abroad, is growing stro

All this threatens to complicate the Fed's job of simultaneously keeping the economy growing while keeping inflation under control. To a great extent, the of strong growth in the U.S. and easy monetary polic abroad partly explains why bond yields have remaine unusually low even in the face of enormous U.S. fina needs. That paradox may well take a long time to un depending on how fast overseas economies regain tr But the process appears to have begun. ■

CONSTRUCTION WORKERS

Dreading a Teardown in Jobs

CONSTRUCTION PAYROLLS once again posted a strong gain, producing 41,000 new jobs in February. But now that the housing market has peaked, construction jobs won't be as plentiful heading into the summer building season. And the impact will not be felt equally across the country.

Over the past year the booming housing market translated into big gains in construction payrolls. Building jobs accounted for over 17% of all new jobs in the U.S. despite accounting for only 5.4% of total payroll. But the National Association of Realtors' March housing forecast projects a 7.7% fall in new home sales this year. Economists also expect February home sales to run below the previous-year pace for the first time in 18 months.

A DOUBLE WHAMMY FOR SOME STATES

STATES WITH BIGGEST HOUSE PRICE APPRECIATION IN 2005		CONSTRUCTION SHARE OF 2005 JOB GAINS
ARIZONA	34.9%	20.6%
FLORIDA	26.8	18.1
HAWAII	23.9	18.4
MARYLAND	21.5	11.4
CALIFORNIA	21.1	24.0
VIRGINIA	19.7	21.4
OREGON	19.5	18.4
U.S.	13.0	17.2

Data: OFHEO, Labor Dept

The states where housing has been especially frothy are vulnerable to a nasty one-two punch. Not only do lofty levels make these markets more vulnerable to falling prices when housing cools, but the impact on labor could be significant.

Construction hiring as a share of total job growth, however, varies among the states with the hottest housing markets. The biggest gains in building jobs over the 12 months through January were concentrated in the West, with increases in California, Idaho, Montana, and Nevada all above 22%. Other states that could feel the pinch of fewer jobs in the sector include New Hampshire, Massachusetts, and Missouri, which saw hiring exce 24% despite 2005 home price g that were below the 13% nation average reported by the Office o Federal Housing Enterprise Ove

Any decline in construction j also will be troublesome becau industry provides well-paying j workers who don't have a colle education. February average w earnings for construction work stood at $744, vs. $553 for all nonfarm workers. The industry growth of hourly wages also ha outpaced the economy at large from last February, vs. 3.6%.

Once housing slows, it will b difficult for many construction workers to find the same amou work at similar wages. That wil compound the pain of a softer h market for several states. ■

–By James Mehring in N

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News you need to know

EDITED BY HARRY MAURER

Ka-Ching! on Wall Street Investment banks are topping themselves again. On Mar. 14, **Goldman Sachs** (headquarters in photo) trumpeted a record $2.64 billion in quarterly net earnings on a record $10.34 billion in revenues. The next day, **Lehman Brothers** chimed in with a record $1.1 billion profit on a record $4.5 billion in revenues. The powerful M&A wave has generated big fee bucks, of course. But Goldman's take on equities trading for clients and its own accounts soared 167% from the previous quarter. And Lehman's asset-management revenues jumped 57% compared with the same period last year.

So how long can the banks keep raising the bar? **Goldman CEO Henry "Hank" Paulson** struck a note of caution in a statement: "While we know that we cannot expect to achieve these results every quarter, we continue to see attractive opportunities." Let's face it: These numbers could get much smaller and still be pretty darn shiny.

See "Goldman's Golden Haul," www.businessweek.com/go/tbw

Spitzer Watch **H&R Block** has more to worry about than the tax man. On Mar. 15, **New York State Attorney General Eliot Spitzer** filed a $250 million suit against the tax preparer, alleging it fraudulently steered clients into its **Express IRAs.** Spitzer claims these tax-friendly accounts—with their not-so-friendly fees and low interest rates—were "virtually guaranteed" to lose money for most clients. The company, which recently said it bungled its taxes and reported that quarterly net earnings fell 69%, plans to "vigorously defend" the Express IRA. Investors whacked the stock by 6%.

See "It's Taxing Times for H&R Block," www.businessweek.com/go/tbw

What's Black and White and Sold? At least on
dia company still sees life in the dead-tree news bus
McClatchy on Mar. 13 agreed to buy larger rival **Knigh**
der for $6.5 billion, including $2 billion in assumed
thus creating the second-biggest U.S. newspaper
McClatchy, known for running a tight shop, is bettin
circulation and sales at its acquired papers will do
thing rare these days: grow faster than the national
age. It plans to keep just 20 Knight-Ridder papers ar
12 others, sending shudders through newsrooms fro
Philadelphia Inquirer to the *San Jose Mercury News.*

See "Newspaper Guy Bets Big," p

Ports: The Aftermath Although the Dubai port
sank on Mar. 9, political jetsam still poses a haza
President George W. Bush's ship of state. **DP World,** the c
ny owned by key Mideast ally the **United Arab Emirates**
to the lifeboats at the Administration's request, ann
ing that it would abandon its plan to take over oper
at six U.S. ports. On Mar. 15, DP World said it would
its U.S. operations to an American company with
months. But members of Congress from both parties
to let a good political issue go, vow to pass legislat
ensure the deal doesn't ever float again.

See "A Homegrown Solution for Keeping Ports Safe," p

More Asian Auto Plants The Asians keep gra
more space in the U.S. auto garage. On Mar. 13,
carmaker **Kia,** owned by **Hyundai,** said it will const
$1.2 billion plant in Georgia, probably to assemble
creating 2,500 jobs. On the same day, **Toyota** con
plans to build its **Camry** sedan at a **Subaru** plant in In
Presto: 1,000 jobs. Meanwhile, **Ford** and **GM** aim t
55,000 factory jobs combined. Forecaster CSM Wor
says foreign-owned plants in the U.S. will turn out
6 million cars and trucks by 2009, a 20% boost ov
year's expected 5 million.

The Keys to GMAC Just a few weeks ago, **GM C**
Richard Wagoner Jr. was talking as if he might not find
er for 51% of the GMAC lending business. Now he m
the makings of an auction. Investment firm **Cerberus**
Management has been kicking the tires, and on Mar.
Wall Street Journal said **Kohlberg Kravis Roberts** is lead
other bid. One GM insider says management is con
will soon get a deal. If so, GM stands to bring in upw
$13 billion, which it can use to fix its cracked cylind
those of its old parts unit, **Delphi.**

See "GM's Dwindling O
www.businessweek.com/

I Want My LSE **NASDAQ** fired the first shot on
but the **London Stock Exchange** pooh-poohed the $4.2
offer, and now the **NYSE** is expected to jump in. The
changes are hot to bag London because it's the b
choice for many foreign companies leery of listing i
ly regulated America.

See "The Yankees Are Coming,"

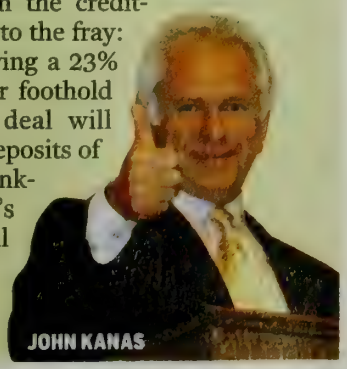
ting for PlayStation The worst-kept secret in the game galaxy is out: **Sony** confirmed on Mar. 15 that **layStation 3** won't hit stores until November, instead of g. The new system, critical to Sony's attempt to win attle for the living room, will do just about everything ie your shoes, and game czar **Ken Kutaragi** concedes packing tons of new technology into one box has n daunting—and costly. Delaying the launch to pre- glitches may be smart, but it means that **Microsoft's 360** will have almost a year's lead, and **Nintendo's Revo-** could blast off earlier than PS3, too.
Sony's Delay of Game," www.businessweek.com/go/tbw

er Pharma in Germany? When all else fails, try g the flag. So figures German drug and chemical con- erate **Merck,** which is promoting its unsolicited $17.7 offer for rival **Schering** as a way to put the country's een pharma industry back in the global big leagues. eal would transform two midsize players into a na- champ with sales of $13.4 billion. For now, Schering ing hard to get: It spurned the offer on Mar. 14 and ing for a white knight or a defensive deal of its own.

g on Fannie More bloopers at **Fannie Mae?** While in- s don't seem to care, pols see a chance to pounce. On 3 the housing finance giant said it had uncovered ad numbers. It can't say how much the latest finds ld to the $11 billion in losses it has already disclosed. e's stock barely budged. But the Bush Administra- nd other critics turned up the volume on demands to e investments held by Fannie and its rival, **Freddie** nd GOP senators want to sharpen scrutiny of the nies' charitable and lobbying practices.

Fat Cats of the Week

g out has its privileges. Take the top three execu- at **North Fork Bancorp,** who stand to receive at least million in payouts following the $14.6 billion ver bid by **Capital One** on Mar. 13. True, **CEO John** is no Johnny-come-lately banking on a big score. ined North Fork in 1971 and became CEO in 1977. ank, which operates in the coveted and lucrative York metro area, has done well over the years by ing business from the even bigger banks around t alienated customers with their serial mergers. Capital One, which until its recent purchase of **Hi-** operated strictly in the credit- ealm, is elbowing into the fray: 1.19 a share, it's paying a 23% um to gain a bigger foothold ail banking. The deal will a contender with deposits of than $84 billion, rank- among the nation's . The integration will lead to cost-cut- ne possible target? ensation.


JOHN KANAS

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ECONOMIC SHIFTS

HOW RISING WAGES ARE CHANGING THE GAME IN CHINA

A labor shortage has pay soaring. That is sure to send ripples around the globe. BY DEXTER ROBERTS

FOR YEARS, YONGJIN GROUP has earned a decent profit selling lamps and furniture to the likes of Wal-Mart, Home Depot, Target, and Pottery Barn. But lately the company has seen its margins shrink to 5%—half what Yongjin made when it opened its factory in the steamy southern Chinese city of Dongguan 14 years ago. Why? Labor shortages are forcing the company to boost wages. Last year salaries surged 40%, to an average of $160 a month, and Yongjin still can't find enough workers. "This business needs a lot of labor," says President Sam Lin. "This is a very tough challenge."

Some 1,500 miles northeast, in the city of Suzhou, Emerson Climate Technologies Co. is facing similar woes. The maker of air conditioner compressors has seen turnover for some jobs hit 20% annually, and Emerson General Manager David Warth says it's all he can do to keep his 800 employees from jumping ship to Samsung, Siemens, Nokia, and other multinationals that are now operating in the tech manufacturing hub. "It has gotten to the point that we are just swapping folks and raising salaries," says Warth.

Wait a minute. Doesn't China have an inexhaustible supply of cheap labor? Not any longer. From the textile and toy factories of the south to the corporate headquarters and research labs in Beijing and Shanghai, the No. 1 challenge today is finding and keeping good workers. Turnover in some low-tech industries approaches 50%, according to the Institute of Contemporary Observation, a Shenzhen labor research group. Guangdong Province says it has 2.5 million jobs that remain unfilled, while Jiangsu, Zhejiang, and Shandong provinces say they, too, face shortages of qualified workers. "Before, people talked about China's unlimited labor supply," says Zhang Juwei, deputy director of the Institute of Population & Labor Economics at the Chinese Academy of Social Sciences in Beijing. "We should revise that: China is facing a limited supply of labor."

Reports of labor shortages first cropped up in late 2004, but companies thought the phenomenon was temporary. Now a surge in both turnover an costs is convincing multinationa their suppliers that the China g changing permanently. With the g tween wages in China and thos where gradually closing, the pres pass price increases on to consu the U.S. and other markets will build. As Citigroup noted in a F report: "The continuous growth costs in China, even at a m pace...is likely to have implication flation worldwide." These factors ally will force the Chinese to u their entire industrial base to make margin goods. And those bigg checks are building a consumer China that multinationals want t

"THERE IS A BREAK POINT"

THE WAGE ISSUE HAS started t how companies operate in China. porations and their suppliers are to rethink where to locate f whether deeper into the interior salaries and land values are sma even farther afield, to lower-cost c such as Vietnam or Indonesia.

IN THIS SECTION:
Will U.S. airlines get a missile defense?
38 Hong Kong's lessons on port security
40 A battle of the bourses over London
43 The workstation meet PlayStation

"Now work is easy to find...there are plenty of choices"

–He Maofang, Yongjin lamp factory, Dongguan

higher labor costs are beginning to price some manufacturers out of more developed Chinese cities such as Shanghai and Suzhou. "There is a break point where people will say this is too expensive," says Michael Barbalas, general manager at the Suzhou plant of Andrew Corp., a Westchester (Ill.) maker of wireless networking gear. At his factory, he says, wages have been rising by 10% annually.

This is a slow process, to be sure. Imports from the mainland have yet to fuel inflation in the U.S. (page 35), while improved productivity in China has so far offset higher wages. But economists say those productivity gains are getting harder to find, and manufacturers who are seeing their margins hit, such as Yongjin, can hold out for only so long before they have to try to raise prices.

The pressure has as much to do with skills as it does with numbers. Although the total labor force is about 800 million, relatively few people have the qualifications employers want. For most textile, toy, and tech-assembly jobs, for example, export-oriented manufacturers prefer women from 18 to 25 years old or people with experience operating machinery. "The skills base does not meet the demands of a rapidly growing market," says C.P. Lee, Asia-Pacific human resources chief at Motorola Inc., which has 9,000 employees in China.

SUZHOU Emers now offers flex hours and free to resort areas

As a result, companies across the board are feeling the squeeze. Last year turnover at multinationals in China averaged 14%, up from 11.3% in 2004 and 8.3% in 2001. Salaries jumped by 8.4%, according to human resources consultant Hewitt Associates LLC.

COST CHALLENGE

And a January report by the American Chamber of Commerce in China found that rising labor costs have pinched margins at 48% of U.S. manufacturers on the mainland. "China runs the risk of losing its advantage" of cheap labor, says Teresa Woodland, an author of the report.

That means managers can no longer simply provide eight-to-a-room dorms and expect laborers to toil 12 hours a day, seven days a week. When 30-year-old He Maofang first arrived in Dongguan in 2000, for instance, "work was hard to find." But "there are ple choices," say who startec Yongjin last Ju addition to bo salaries, Yongj upgraded its tories and im the food in the company cafeteria. I those efforts, its five factories about 10% shy of the 6,000 emp they need.

Many companies are compensat the shortages by penetrating deep China's vast heartland, where wag be half what they are on the coast. al Motors, Honda, Motorola, and In instance, have all shifted some ma turing or research to inlan tions in recent years, both lower costs and to open u markets. But a two-year-old by the Chinese government to ral incomes through tax cuts is k some potential factory workers farm. So with investment growing interior, labor shortages are popp there, too. "More and more multi als are looking for opportuni second-tier cities," boosting there faster than in the traditional facturing strongholds farther ea Jean Lin, head of the compensatio tice at Hewitt.

BETTER TRAINING

THE TREND GOES BEYOND the Only about 10% of Chinese candid jobs in key areas such as finan counting, and engineering are qua work for a foreign company, es consultant McKinsey & Co. Whil today has fewer than 5,000 m with the skills needed by multina 75,000 jobs for such managers pected to be created over the n years, McKinsey says. The talent "is the No. 1 constraint on growth," says Andrew Grant, McK China chief. "It will hit earlier more powerful than any [othe straint," such as raw materials sh

Some U.S. companies in China better education and training is to stay ahead of the game. Motoro larly hires graduates straight fron and then trains them at its "M University" in Beijing. Intel Corp

invested $1.3 billion in chip bly, testing, and research and de- nent in China, has backed initia- hat have trained 600,000 teachers "It helps contribute to our future orce," says Intel China President heng Tan.

R ENERGY BILLS

RS ARE DOING everything they can ain employees. St. Louis-based on has introduced flexible work at its Suzhou plant for workers with n. It has built a "green" office with power, ambitious recycling plans, argers for the electric bicycles used y staffers. And to build loyalty the ny holds quarterly parties for the staff and organizes free trips to re- eas. "I chose Emerson because it is respected company," says 25-year-old Rocky Lu, who started as a technician at Emerson's Suzhou plant in February. He got a 50% raise from his last job, at a state enterprise, to nearly $400 a month.

Emerson is cutting costs elsewhere to ensure that rising wages don't price it out of Suzhou. It has lowered utility bills by raising the thermostat a couple of degrees in the summer and dropping the mercury in the winter while passing out long underwear to keep workers warm. It has added reflective light fixtures that can use lower-wattage bulbs. And it has recently tapped excess heat from its factory to warm dormitory showers. "So far it's an even trade-off" between rising labor costs and efficiency gains, says Emerson manager Warth. "We have to deal with it if we want to remain in business."

Managers are in short supply, too: China will need 75,000 in five years

Beijing realizes that it, too, needs to deal with the issue if it wants to stay in business. So the government is further loosening rules that prevent rural residents from moving to cities to work and is offering tax breaks to overseas Chinese who return to the mainland. The higher education system is also being overhauled to include more practical classes and vocational training in a bid to expand China's skilled workforce by a third, to 8% of the population. China will still be the world's workshop. But the world will need to adjust to the inexorable rise of the workshop's wages. ■

FLATION

nports from China Aren't Pricier—Yet

f the wages of U.S. workers were rising at 10% per year, you can be sure economists would be sounding the inflation alarm bells. After all, even the slightest sign of an upward surge in costs brings calls for the Federal ve to boost interest rates even faster. t what if it's Chinese wages that are at a 10% pace? Should the Fed care? era of globalization it sometimes feels Guangdong and China's other trialized provinces are extensions of S economy. Indeed, the value of cheap ts from China—about $240 billion in —exceeds the net revenues of the U.S. ties industry. With that large an t, it wouldn't be a surprise if soaring in China translated to import prices and faster on in the U.S.

tainly, policymakers at the e aware of this possibility. ght-thinking businessman nan, whether in El Paso or t, thinks in terms of the ly now," says Richard W. president of the Federal e Bank of Dallas. Said Fed nor Donald L. Kohn in a last October: "We cannot t the possibility that zation might someday even create inflationary pressures [in the U.S.] on balance."

But here's the surprise: For now the cost increases in China are not being passed through to U.S. prices. The latest data from the Bureau of Labor Statistics, released on Mar. 15, show that the price of imports from China has fallen by 0.4% over the past year, vs. a 1.8% rise in the price of non-oil imports from all countries. In part, rapid productivity jumps in Chinese manufacturing may be allowing employers to pay higher wages and still keep prices low.

Equally important, foreign manufacturers, in China and elsewhere, seem increasingly willing to take a hit against profits rather than raise prices when their costs go up. That's what research from the Federal Reserve suggests. In the 1980s more than half of foreign cost increases because of exchange rate changes show up in the form of higher import prices in the U.S. Today, research shows, only about one-fifth of cost hikes are passed through, perhaps because importers want to keep their share of the U.S. market.

These days manufacturers in China seem unable to pass on the higher costs. Wage inflation is "eating into margins. There is very little pricing power in China—or globally, anywhere—anymore," says Michael Barbalas, general manager at the Suzhou factory of Andrew Corp., a Westchester (Ill.) maker of wireless networking gear. "You can't negotiate with Wal-Mart, and if you're selling to the large electronics [original equipment manufacturers], you don't have a lot of pricing power, either."

True, manufacturers in China can't absorb higher costs forever, especially if Chinese wages keep climbing. But today Fed policymakers still care more about wages in New York and Kansas City than in Shanghai or Beijing.

–By Catherine Yang in Washington

TERRORISM

HESITATION AT HOMELAND SECURITY

A high-tech missile defense for passenger jets now exists, but plans to install it don't

BY LORRAINE WOELLERT

IT'S A HORRIFYING SCENARIO: A lone terrorist hiding near a U.S. airport targets a passenger jet with a shoulder-fired missile. Beyond any immediate carnage, the inevitable ripple of fear could paralyze the travel industry and cripple the economy.

The Bush Administration ranks portable missiles—some of which are thought to be in the hands of al Qaeda and other fanatic groups—as a leading terrorist menace. In September, 2005, the State Dept. warned of "a serious potential threat to passenger air travel [and] the commercial aviation industry."

But at the Homeland Security Dept., the alarm is more tempered. The agency is winding down a three-year study of how to adapt military antimissile technology to civilian planes. Contractors doing the research say results so far are promising. But as Homeland Security phases out its antimissile research budget—to $4.8 million for 2007, down from $109 million this year—the agency shows little interest in buying the gear. "Until we know whether this approach is a good approach or not, I think that that is something we just are not prepared to promise money for," Homeland Security Secretary Michael Chertoff told the House Homeland Security Committee last month.

Another reason for Chertoff's hesitation: The roughly 30 shoulder-fired missile attacks on civilian aircraft in the past three decades were all in overseas hot spots. "We do take it seriously, but we base [Homeland Security's position] on the risk assessment of, 'Could it happen here?' " says Brian Doyle, a department spokesman.

Such ambivalence worries skeptics of every stripe. Alane Kochems, a national security analyst at the conservative Heritage Foundation, says that without Administration leadership, Congress isn't lik take the initiative and fund defens tems for American planes. Homela curity "doesn't have clear policy lines, and they're not putting a money out there because they don' know what they want," she says.

Representative Steve J. Israel (D asserts that intelligence experts "all that this is one of the most glarin nerabilities to our homeland securi the White House and DHS insist on ful thinking that it's not." Shoulde missiles typically weigh less th pounds and can be hidden in a go They can fire up to 23,000 feet, an of thousands are unaccounted for a the world. Israel has introduced a force Homeland Security to set a sc for buying missile-defense devic the legislation has little momentu

It was at Congress' behest in 20 the agency began testing milita nology on commercial jets. Sens tached to a plane's hull detect an i ing heat-seeking missile and lasers or flares, an alternate heat that throws the missile off course.

In two studies for Homeland S contractors Northrop Grumman and BAE Systems Inc. are testing t tem on working cargo planes—so no significant glitches, the compa Homeland Security will release e sults this spring. "This is an oper ly effective system. We've done work in making it commercially says Stephen duMont, BAE's di commercial aircraft programs. If ernment mandated the technolo and Northrop would expect to selling it.

Homeland Security's Cher

VULNERABLE Tens of thousands of portable missiles are unaccounted for

Surprise Attacks

Shoulder-fired missile assaults on civilian planes have become a threat:

NOV. 22, 2003
A DHL Airbus A300 cargo jet transporting mail in Iraq landed safely after being hit, but the plane was a total loss.

NOV. 28, 200
Two missiles misse Israeli jet with 271 passengers and cr during takeoff from Mombasa, Kenya.

DEC. 26, 1998
UNITA rebels brought down a U.N. Lockheed C-130, the first of two in the span of a week. Fourteen were killed.

OCT. 10, 1998
A Congo Airlines Boeing 727 was downed over the Congo by Tutsi rebels, killing all of the 41 people on board.

APR. 6, 199
A small jet carrying presidents of Rwan Burundi was shot d killing all aboard ar sparking regional c

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warned that the steep cost of defending against missiles would have to be shared by taxpayers and the airline industry. That has made the financially weak industry an opponent of the technology, although air carriers have kept a low profile on the sensitive issue. At an estimated $1 million a plane, it would cost $7 billion to equip the U.S. passenger fleet's 6,800 aircraft. Added maintenance and fuel costs (because of the weight and drag of the gear) could tack on $27 billion or more over 20 years, according to Santa Monica (Calif.) researcher RAND Corp.

"We think the better choice is to continue to work to get those missiles out of the hands of the bad guys and secure airport perimeters," says David A. Castelveter, vice-president of the Air Transport Assn., a trade group. El Al Israel Airlines made a different choice. In December it said it would become the first carrier to install the technology. Five of its planes have been outfitted with the devices. ■

TERRORISM

A HOMEGROWN SOLUTION FOR KEEPING PORTS SAFE

Sophisticated American scanning technology is being tested in Hong Kong. Why not at home?

BY BRIAN BREMNER

THE DUBAI PORTS World affair sure touched a nerve in the U.S. over the vulnerability of domestic ports to terrorist attack. Although U.S. authorities thoroughly inspect the 5% of cargo containers they identify as high-risk, only 45% of all containers pass through the most accurate radiation scanners. U.S. ports needn't be so vulnerable. At the Port of Hong Kong, a pilot program scans every container of cargo at two terminals of the megafacility with sophisticated radiation and gamma-ray screeners. Since late 2004 the setup has generated 1.4 million digital profiles of outbound containers at the port, the second busiest in the world behind Singapore.

The big irony is that Hong Kong's port is using American technology. San Diego-based Science Applications International Corp., a $7.2 billion research and engineering company that does systems integration work for the U.S. government and is readying an initial public offering in 2006, designed Hong Kong's Integrated Container Inspection System (ICIS). The $10 million system can scan nearly 400 container trucks an hour and provide real-time data to help identify suspicious cargo, all the while keeping detailed records of what passes through the port.

DRIVE-THROUGH SCAN ICIS checks nearly 400 containers an hour

So why isn't the U.S., which produces the world's most sophisticated high-tech port-protection technology, rushing to install this gear? So far, the U.S. has preferred to beef up security overseas—stationing U.S. Customs inspectors in 43 foreign ports. But Hong Kong's i spection program has caught th Homeland Security Secretary I Chertoff. He plans to tour the IC ect in April.

Here's what Chertoff will find: Container trucks in Hong Kong pass under two giant portals that first scan for radioactivity. Gamma-ray imaging checks for odd-sized objects that might conceal weapons. An optical scanner retrieves the ID numbers on the container while a computer integrates data into base that could be accessed b worldwide.

THE
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HUGE COSTS

SO FAR THE U.S. has been relu embrace such high-tech solution September 11, Washington l creased the U.S. Coast Guard fivefold, to $1.5 billio $708 million in grants ports. Yet U.S. authoritie that the new high-tec ning systems are unpro

Then there's the Stephen E. Flynn, a terro pert with the Council on Relations and ex-Scienc cations adviser, figures i cost $1.5 billion to inst systems at major contair worldwide. Managing t tracking the data would quire a huge outlay, but covered by a $50 to $1 charge per container shipping companies.

Sensing big opportun er U.S. companies such Communications Syste Ocean Shipholdings are ing with Science Appl for contracts to build po rity gear. The U.S. is er ing the rollout of more s gear at U.S. ports, but not on the ICIS yet. Overseas port executive while, are streaming into Hong port for a look-see. There could brant global market for such syst so far, at least, that market doesn to U.S. shores. ■

–With Dawn Kopecki in Wa

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CROWN JEWEL The sun never sets on the London market

BOURSES

THE YANKEES ARE COMING!

The NYSE and NASDAQ look ready to start bidding for the London exchange

BY JOSEPH WEBER

WHEN U.S. STOCK exchanges look longingly at the London Stock Exchange, they see a lot more than just another thriving offshore market. They see a rival that's snaring new business they can't touch: stocks in foreign companies that steer clear of NASDAQ and the New York Stock Exchange because of cumbersome U.S. regulations. "The LSE has become the dominant marketplace for foreign listings," says market watcher Benn Steil, director of international economics at the Council on Foreign Relations.

That's why U.S. exchange executives may be about to engage in a bidding war for the 205-year-old British market. The LSE "is a unique property," says Douglas Atkin, chief executive of New York-based Majestic Research Corp., which tracks exchanges. "Once it's gone, it's gone." On Mar. 10, NASDAQ Stock Market Inc. made the opening bid, for $4.2 billion. The LSE declined, and investors quickly bid up its shares, expecting a bigger offer. Its market value now sits at around $5.3 billion, and NASDAQ officials plan to talk with some of the exchange's big shareholders.

Analysts expect the NYSE to join the fray any time now. NYSE chief John A. Thain, eager to play in global exchange consolidation, has said he would like to link with one of three major foreign exchanges—London, Paris-based Euronext, or Frankfurt's Deutsche Börse. Thain would have to push to win over Paris or Frankfurt, however, because the two European exchanges are now talking with one another. The NYSE declined comment.

The overseas exchanges, especially the LSE, have been winning listings from companies from Asia and Russia. The NYSE was stung a few years ago when big-name Russian giant Lukoil chose to list on the LSE instead of New York. And just last year, Russian telecommunications powerhouse Sistema opted for London, where it raised $1.56 billion, even though a subsidiary, Mobile TeleSystems, trades in New York. "The key success story is Russia," says LSE Senior Manager Jon Edwards. The n has been hot for comers. Throug end of Feb 2006, a dozen raised $4.6 billion on the LSE's market, where larger companies tra additional 59 collected $304 milli debuting on an in-house alternative ket for smaller companies. Betwee markets, the LSE last year attracte companies that raised $30.3 billior

THE STAT

30

Foreign companies that have left NASDAQ and the NYSE since 2004

NEW YORK TURNOFFS

THE NYSE AND NASDAQ, mean have lost some foreign listings la with 30 quitting the two since the 2004. Last year alone, the LSE attra record 129 companies from 29 cou an 82% hike. Why swinging Lo Some 90% of the outfits that looke U.S. listing blamed the stiff require under the Sarbanes-Oxley Act, say I ficials. In Britain, executives who vertently break the rules might los jobs. But "if you break the rules in ica, you go to jail," says Clem Chambers, CEO of ADVFN, a Britis site that tracks the markets.

London also would offer a buy largest, most liquid market outside U.S. The LSE boasts 3,100 listed c nies worth $7.5 trillion, and the capital is a financial center rivale by New York. Whoever owns the L count on huge volumes from hedge funds, and other big-time t In the U.S., by contrast, liquidity among NASDAQ, the NYSE, and electronic upstarts, offering in lots of choices.

Just what is the LSE worth? Michael Long of Keefe, Bruyette & Inc. figures NASDA still make money LSE from the start the price climbed al billion. With the val more than $5 b higher than NASDA market worth—such might not be out of

Still, the bidding at a bad time for t exchanges. While N is keen to beat out a er rival, it is busy i ing other acquisitions. And the modernizing technology and adju life as a publicly traded entity.

The battle for London is on, And the winner will walk away wi global prize.

–With Kerry Capell in

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LIPITOR is not for everyone. It is not for those with liver problems. And it is not for women who are nursing, pregnant or may become pregnant.

If you take LIPITOR, tell your doctor if you feel any new muscle pain or weakness. This could be a sign of serious muscle side effects. Tell your doctor about all the medicines you take. This may help avoid serious drug interactions. Your doctor should do blood tests to check your liver function before and during treatment and may adjust your dose. The most common side effects are gas, constipation, stomach pain and heartburn. They tend to be mild and often go away.

Please see additional important information on next page.

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IMPORTANT FACTS

LIPITOR
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(LIP-ih-tore)

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- People who cannot lower their cholesterol enough with diet and exercise
- Adults and children over 10

Who should NOT take LIPITOR:

- Women who are pregnant, may be pregnant, or may become pregnant. LIPITOR may harm your unborn baby. If you become pregnant, stop LIPITOR and call your doctor right away.
- Women who are breast-feeding. LIPITOR can pass into your breast milk and may harm your baby.
- People with liver problems
- People allergic to anything in LIPITOR

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Tell your doctor:

- About all medications you take, including prescriptions, over-the-counter medications, vitamins, and herbal supplements
- If you have muscle aches or weakness
- If you drink more than 2 alcoholic drinks a day
- If you have diabetes or kidney problems
- If you have a thyroid problem

ABOUT LIPITOR

LIPITOR is a prescription medicine. Along with diet and exercise, it lowers "bad" cholesterol in your blood. It can also raise "good" cholesterol (HDL-C).

LIPITOR can lower the risk of heart attack or stroke in patients who have risk factors for heart disease such as:

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- diabetes with risk factor such as eye problems, kidney problems, smoking, or high blood pressure

LP270114-A

POSSIBLE SIDE EFFECTS OF LIPITOR

Serious side effects in a small number of people:

- **Muscle problems** that can lead to kidney problems, including kidney failure. Your chance for muscle problems is higher if you take certain other medicines with LIPITOR.
- **Liver problems**. Your doctor may do blood tests to check your liver before you start LIPITOR and while you are taking it.

Symptoms of muscle or liver problems include:

- Unexplained muscle weakness or pain, especially if you have a fever or feel very tired
- Nausea, vomiting, or stomach pain
- Brown or dark-colored urine
- Feeling more tired than usual
- Your skin and the whites of your eyes turn yellow

If you have these symptoms, call your doctor right away.

The most common side effects of LIPITOR are:

- Headache
- Constipation
- Diarrhea, gas
- Upset stomach and stomach pain
- Rash
- Muscle and joint pain

Side effects are usually mild and may go away by themselves. Fewer than 3 people out of 100 stopped taking LIPITOR because of side effects.

HOW TO TAKE LIPITOR

Do:

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- Try to eat heart-healthy foods while you take LIPITOR.
- Take LIPITOR at any time of day, with or without food.
- If you miss a dose, take it as soon as you remember. But if it has been more than 12 hours since your missed dose, wait. Take the next dose at your regular time.

Don't:

- Do not change or stop your dose before talking to your doctor.
- Do not start new medicines before talking to your doctor.
- Do not give your LIPITOR to other people. It may harm them even if your problems are the same.
- Do not break the tablet.

NEED MORE INFORMATION?

- Ask your doctor or health care provider.
- Talk to your pharmacist.
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Rx onl

TUAL WORKPLACE

N-THE-JOB IDEO GAMING

eractive training tools are captivating ployees and saving companies money

EENA JANA

aura Holshouser's favorite video games include *Halo, Tetris,* and an online training game developed by her employer. A training game? That's right. The 24-year-old graduate student, who es a Cold Stone Creamery ice- store in Riverside, Calif., stumbled the game on the corporate Web October.

eaches portion control and cus- service in a cartoon-like simulation ld Stone store. Players scoop cones the clock and try to avoid serving ch ice cream. The company says han 8,000 employees, or about the total, voluntarily downloaded ne in the first week. "It's so much ays Holshouser. "I e-mailed it to e at work."

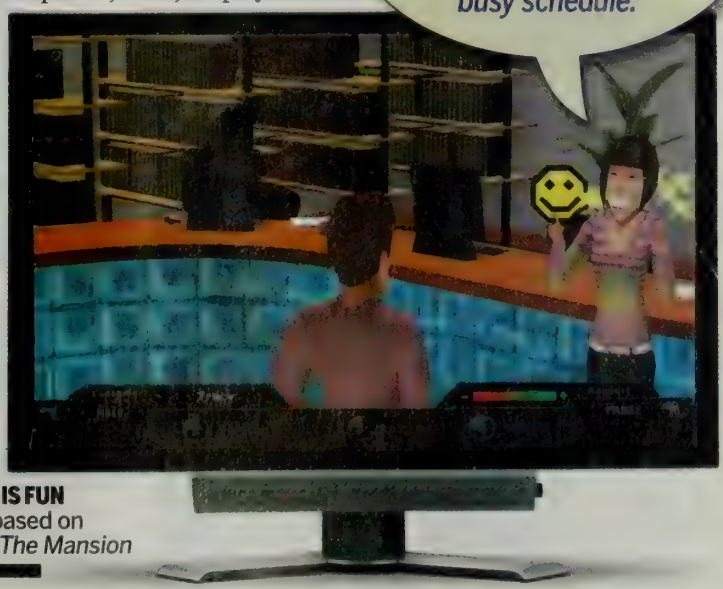
military has used video games as a tool since the 1980s. Now the e is catching on with companies, anging from Cold o Cisco Systems Inc. ion Inc. Corporate are betting that interactivity and fun ok young, media- mployees like Hol- and help them d retain sales, tech- and management Video games teach e management, col- on, critical thinking, erance for failure," Sawyer, who runs ill Inc., a game con- in Portland, Me..

he market for ne training es small but ing fast.

Sawyer estimates that such games make up 15% of the "serious," or nonentertainment market, which also includes educational and medical training products. Over the next five years, Sawyer sees the serious-games market more than doubling, to $100 million, with trainers accounting for nearly a third of that. It's numbers like those that prompted Cyberlore Studios Inc., maker of *Playboy: The Mansion*, to refocus on training games—albeit based on its Playboy title. And training games will be top of mind at the Game Developers Conference in San Jose, Calif., this month.

Companies like video games because they are cost-effective. Why pay for someone to fly to a central training campus when you can just plunk them down in front of a computer? Even better, employees often play the games at home on their own time. Besides, by industry standards, training games are cheap to make. A typical military game costs up to $10 million, while sophisticated entertainment games can cost twice that. Since the corporate variety don't require dramatic, warlike explosions or complex 3D graphics, they cost a lot less. BreakAway Games Ltd., which designs simulation games for the military, is finishing its first corporate product, V-bank, to train bank auditors. Its budget? Just $500,000.

To start with, you did a great job handling the initial contact, by building rapport with me and showing sensitivity to my busy schedule.



HEY, THIS IS FUN
A game based on *Playboy: The Mansion*

DRAG AND DROP

GAMES ARE ESPECIALLY well-suited to training technicians. In one used by Canon, repairmen must drag and drop parts into the right spot on a copier. As in the board game *Operation*, a light flashes and a buzzer sounds if the repairman gets it wrong. Workers who played the game showed a 5% to 8% improvement in their training scores compared with older training techniques such as manuals, says Chuck Reinders, who trains technical support staff at Canon. This spring, the company will unveil 11 new training games.

Games are also being developed to help teach customer service workers to be more empathetic. Cyberlore, now rechristened Minerva Software Inc., is developing a training tool for a retailer by rejiggering its *Playboy Mansion* game. In the original, guests had to persuade models to pose topless. The new game requires players to use the art of persuasion to sell products, and simulates a store, down to the carpet and point-of-purchase display details.

Don Field, director of certifications at Cisco, says games won't entirely replace traditional training methods such as videos and classes. But he says they should be part of the toolbox. Last year, Cisco rolled out six new training games—some of them designed to teach technicians how to build a computer network. It's hard to imagine a drier subject. Not so in the virtual world. In one Cisco game, players must put the network together on Mars. In a sandstorm. "Our employees learn without realizing they are learning," says Field. Sounds suspiciously like fun. ■

ASIA

NOKIA CONNECTS

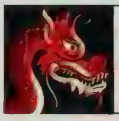
These days the Finns are making all the right moves in the key markets of China and India

BY BRUCE EINHORN AND NANDINI LAKSHMAN

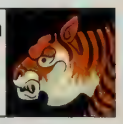
It wasn't hard for Wang Ninie to decide on a mobile phone. In early March the twentysomething Beijing entrepreneur saw a golden Nokia handset with a flower pattern etched into the trim, one of the company's "L'Amour" line of high-end designer phones. "I fell in love with it," she says. At $470, the phone wasn't cheap, and she had to wait a few hours for delivery since the shop didn't have one in stock. No matter. Wang knew she had to have it. "I didn't even look at other phones," says Wang, who has recommended the handset to friends.

Jeevanlal Pitodia is equally smitten with Nokia. The 27-year-old Bombay fruit vendor used to spend his days pounding the pavement in the city's alleys, hawking oranges, apples, and bananas. Last September, Pitodia ponied up $56 for his first handset, a simple but sturdy Nokia 1100. Now he sits under a colorful beach umbrella, earning as much as $10 a day taking orders by phone for both himself and nearby vendors. "I tried many phones, but Nokia is the most user-friendly," says Pitodia. "I am the only one in the footpath with a mobile," he says proudly.

More than any other handset maker, Nokia Corp. has connected with the likes of Wang and Pitodia and their billions of countrymen. In both China and India, the Finnish company is the top brand. In China last year, it had nearly 31% of a crowded market, well ahead of the 10% controlled by No. 2 Motorola Inc. Nokia's sales in



For more on China and India, go to: www.businessweek.com/asia



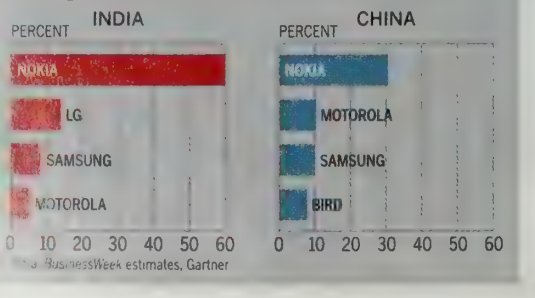
Greater China (the mainland, Hong Kong, and Taiwan) jumped by 28%, to $4.5 billion. The region today is the company's biggest market, accounting for 11% of global revenues, compared with 8% in the U.S. In India, Nokia has a 60% share, with sales last year of about $1 billion. By 2010 the company expects India to be its No. 2 market.

Nokia isn't letting up: On Mar. 11 it opened its first Indian factory, a $150 million facility near the southern city of Madras that will turn out as many as 20 million inexpensive phones annually both for the local market and for export. And the company is doubling the size of its plant in the Chinese city of Dongguan, near Hong Kong.

INDIAN FLAIR Nokia has 60% of the market

NOKIA'S BIG NUMBERS

Smart marketing has given the Finnish giant a big lead where mobile sales are hottest

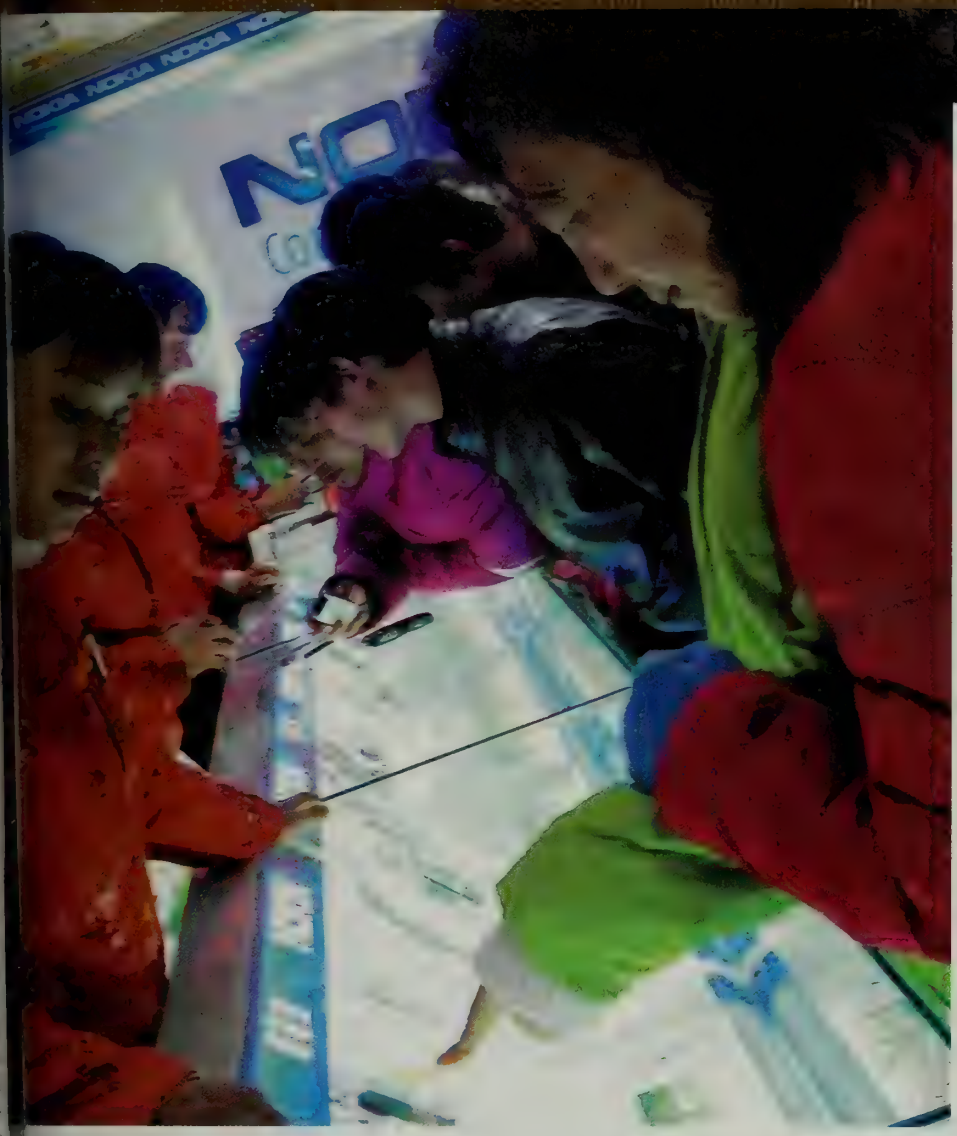


BusinessWeek estimates, Gartner

The two Asian giants are of fundamental importance for Nokia. The Finnish company has played catch-up in the U.S., where Motorola has beaten it with hot-selling models such as the ultra-thin RAZR. But the U.S. market is nearly saturated. The company that can control Asia's Big Two will have a lead in the global handset wars. Today, China is the world's No. 1 cellular market, with 400 million users and growth last 20%. While India is far smaller, w 81 million users in February, h sales are expected to double this y total users could hit 500 million b "China and India are critical to overall strategy and they can o more important," says Neil Maws sociate director of consultancy S Analytics.

"CAUGHT OFF GUARD"

JUST A FEW YEARS AGO, Nokia fa troubles in both countries. In growth was sluggish. Nokia was a mover—the country's first cell-ph was made on one of its handse regulation hindered expansion. In Nokia not only trailed Motorola threatened by ascendant domestic such as TCL and Ningbo Bird, new to the business that had quickly up almost half of the market with expensive but well-designed h The Finns "were caught off guar rise of the domestic vendors," s Dean, managing director at BD



CHINA CARD Nokia has beefed up its distribution nationwide

Beijing consulting firm. "Sudden-
a was struggling."
local upstarts flooded stores na-
e with armies of sales assistants
their brands. "Our people would
posters, and within 30 minutes
uld be torn down," recalls Colin
anager of Nokia's China handset
s. Visiting a shop in the western
Chengdu, Giles says, "you could
move in the store because of the
of salespeople."
ht back, Giles pushed through big
. Nokia decentralized, going from
inese sales offices in 2003 to 70
stead of eight national distribu-
kia now has 50 provincial ones.
ce rivals were having great suc-
handsets designed for mainland
okia introduced its own China-
models. For instance, since many
inese aren't familiar with the ro-
transliteration system that most
nes use to input Chinese for text
s, Nokia developed two phones
ware that lets them write charac-
a stylus. And Nokia invested in
puter systems that provide de-
tailed sales data. "Tomorrow, I will be able to tell you what happened today in the top 4,500 outlets," Giles boasts. "In a week's time, I will be able to tell you about 30,000 outlets." The result: Nokia sold 27.5 million handsets in China last year, triple what it sold in 2003. Now, the company is planning for the launch of 3G in China, expected this year.

Since 2002, when India's cellular market took off, Nokia has drawn on its China experience to consolidate its lead. In 2004 the company launched two India-specific models, which included a flashlight, dust cover, and slip-free grip (handy during India's scorching, sweaty summers). Nokia introduced software in seven regional languages for non-Hindi speakers and added ringtones of patriotic songs such as the nationalist hymn *India Is the Best*. And the company's marketers pitched the phones through ads tailored to India, with one early campaign showing burly truck drivers calling home on Nokia handsets. "We invested when the market was nothing," says Robert Andersson, who oversees manufacturing, sales, and marketing at Nokia. "We have been able to harvest the fruits of that commitment in the last four years."

> "We invested when the market was nothing," says a Nokia exec in India

FIERCE RIVALS

NOKIA HAS ALSO reaped the fruits of rivals' missteps. Motorola was slower in reacting to the threat from the Chinese locals and has had a tougher time bouncing back. "Motorola didn't change its strategy for a long time," says Chris Han, an analyst in Beijing at Norson Telecom Consulting. The Chinese upstarts, meanwhile, have suffered sharp reversals due to disappointing quality. In India, Motorola didn't focus on the market early enough, says Pankaj Mohindroo, president of the Indian Cellular Assn., a trade group. Today its share there is just 5% or so.

Rivals say the time is right to eat into Nokia's lead. Samsung in the past focused solely on the middle to high end of the market in India but began selling lower-cost phones last year. And on Mar. 7 the Korean company opened a new factory in Gurgaon, near Delhi. Motorola has revamped its structure in China, expanding its sales force and strengthening its distribution network to cover 300 cities. By February, Motorola had boosted its market share by several percentage points. "We've done a lot of the blocking and tackling," says Michael Tatelman, Motorola's China chief. And in India, Motorola is planning to market phones costing as little as $35. Motorola Vice-President Allen Burnes calls India "pivotal" and says the company will open its first factory there in 18 months. Of course, that's 18 months behind Nokia, giving the Finns another opportunity to solidify their lead in Asia's Big Two. ■

–With Manjeet Kripalani in Bombay and Jack Ewing in Frankfurt

OVERSEAS PULL Emirates' Dubai base is a flourishing link to Asia

DUBAI

AN AIRLINE WITH A DEAFENING ROAR

Why Dubai's fast-growing Emirates gets to call the shots with Boeing and Airbus

BY CAROL MATLACK

HABIB FEKIH WAS TRAVeling in the Mideast as a salesman for European planemaker Airbus in 1985, the year Dubai's ruling family set up a dinky airline called Emirates to shuttle Pakistani workers between Dubai and Karachi aboard two leased planes. "Nobody believed Emirates could be a successful airline," recalls Fekih, who now heads Airbus' Mideast subsidiary. "It was the joke of the day."

Nobody's laughing now. Emirates today is the world's 10th-largest airline, winning praise for top-notch service as it expands everywhere from New York to New Delhi. And it's buying airplanes at an astounding rate, with $37 billion on order and billions more expected soon. No other carrier's order book comes close. That gives Emirates unparalleled clout with Airbus and Boeing Co., the more so because Emirates buys only widebodies, the aircraft makers' most profitable models. Indeed, Emirates is already forcing Airbus and Boeing to design new widebody planes to its specifications and to undertake costly revamps of existing models.

Following the Dubai Ports World controversy, could Emirates use that power to hurt U.S. exports by steering multibillion-dollar orders to Airbus instead of Boeing? Aviation industry experts say Dubai's rulers are unlikely to let politics sway their purchasing decisions.

But Emirates and its blunt, British-born president, Tim Clark, sure know how to make suppliers sweat. He recalls that when Boeing was considering launching its new long-range 777-300ER, its program chief, Lars Andersen, "came to me and asked, 'What do I need to do to get you to buy this plane?'" In exchange for carte blanche on design specs, including size and flying range, Emirates ordered 46 of the new planes, more than any other carrier. "Clark knows what he wants, and we listen," says Scott Carson, Boeing ecutive vice-president for sales.

THE STAT

$37 BILLION

Emirates' aircraft order book, the world's largest

In hopes of snaring orders for 40 planes from Emirates, Airbus ha worked plans for its new A350 with wing design and other modification have added more than $1 billion to opment costs. Boeing, with its Dreamliner competing for the san der, could buckle to pressure from to develop a stretch model with up seats. Clark is warning Airbus tha doesn't spend millions to improve th efficiency of its A340-600 jet, Em could cancel or delay its $4 billion "Oh yes, we are working them ove says. While most airline executive mum about their talks with the makers, Clark steps up the pressu speaking openly about his demand

DOUBLE-DECKERS

THIS UPSTART has buying musc right. And with a fleet set to grow fr to more than 150 planes by 2012, i ing 45 of Airbus' new A380 double er megaplanes, Emirates can ke panding from its Dubai hub. But that projected growth prove to be rage? Dubai's population is only 1 n and Emirates is still a fraction the the top U.S. and European carri growth stalls, billions in Boeing a bus orders could evaporate.

Not likely. Clark and Emirates man Sheikh Ahmed bin Saeed a toum have shrewdly developed Dul hub linking Europe and the U.S booming Asian markets. Clark, w run Emirates since its founding, i eran airline executive who has live Mideast for 30 years. The carrier $637 million in profits last year o billion in sales. Its flig 70% full, on aver healthy ratio. Travele about extras such as channel in-flight ent ment system. "It's l difference between a and a really nice hote Fred Watts, a busin waiting in Emirates' s ous lounge at Jo Kennedy Internation port in New York.

There are some clo the horizon. Mideast political insta a constant worry, and as other car quire longer-range aircraft, Dubai' tion as a hub could diminish. But Emirates looks set to stay on cour to keep buying those planes. ■

–With Stanley Holmes in

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The Fraternal Order Of Fraud Victims

Investment scams targeting social, religious, and ethnic groups are on the rise

BY AMY BORRUS

THREE YEARS AGO, TAI Kim was barely making ends meet. Despite working 12-hour shifts in a print shop in Boston, the 32-year-old Cambodian immigrant, who came to the U.S. in 1989, was struggling to support his wife and two children in nearby Lowell, Mass., as well as family back home.

Then a friend introduced Kim to Seng Tan, an elegant Cambodian-American woman who said she wanted to help her people live the American dream. If he invested $131,933 in her vitamin and cosmetics company, World Marketing Direct Selling Inc. (WMDS), he would get $2,500 a month for life, she said. Many of Kim's friends in Lowell, which is home to more than 30,000 Cambodians, had invested and were getting checks regularly. Kim thought: Why not?

With Tan's help, he refinanced his house in April, 2003. The bank she recommended approved his $145,000 home-equity loan in just a week, with no appraisal. Kim gave her $131,933, and for two years, $2,500 checks rolled in monthly.

Last July they stopped. Tan offered excuses: a computer glitch, Hurricane Katrina. But in November, Kim learned that WMDS was a sham. On Nov. 15, the Securities & Exchange Commission filed a complaint against Tan and two associates. Federal prosecutors in Boston have since filed 11 counts of mail fraud against the trio. Investigators say the three bilked $30 million from hundreds of Cambodian-American investors from Massachusetts to Minnesota. Lawyers for all three deny the charges.

Like Kim, many of the alleged victims invested funds from home-equity loans. Kim anguishes about how he will make home loan payments that have nearly tripled. "What will happen to my family, here and in Cambodia?" he wonders. "This is very painful. I will carry it with me my whole life."

As the wave of corporate crime subsides, the SEC is zeroing in on small-time swindlers. It doesn't keep statistics on affinity fraud, but federal and sta forcers say schemes that prey on bers of ethnic, religious, and groups are on the upswing. "A fraud is rampant," says Alabama S ties Commission Director Joseph P "It seems like every third case has affinity element to it."

KIM The Cambodian immigrant lost $131,933 investing in a sham company

Taken for a Ride

HAITIAN AMERICANS In June, 2005, the SEC charged a Florida firm with defrauding 600 Haitian Americans

MASONS In December, 2005, a financial adviser pleaded guilty to bilking $27 million from 125 investors, many of them fellow Masons with whom he socialized

CHURCHGOERS In October, 2005, a Florida judge sentenced an investment adviser to more than 14 years in prison for defrauding churchgoers of $16.5 million

MISPLACED TRUST

ONE REASON IS THE growing aff of immigrants and other religious a cial groups, fueled by the real boom. "More people have accum wealth but lack the educational ground to know who to trust for ment advice and opportunities," sa Fairfax, associate professor of law University of Maryl

Affinity scams ty take the form of schemes, in which from new invest channeled to exist vestors. Fraudsters the illusion that distributing profits business or sec portfolio, but they money they collect earlier victims an the rest. Investiga the trail of WMDS checks drawn on a ny bank account t paid for a $38,0 mond ring and $2 for a Las Vegas trip

Affinity swindle on their victims' that they are shut mainstream societ pitch is: 'The [know] a secret just not telling y we know it and we it for you,'" says S forcement Directo Chatman Thomse

The trend has pr securities regulat step up investor ed outreach to vul groups. Last Sep after Haitian Amer South Florida were off in an affinity scam, the SEC a authorities hosted a town hall where Creole speakers gave tips o ing wisely. In other states, regula trying to get the word out throu nerships with AARP and churches. wave of fraud is spreading the n The ties that bind can also bilk. ■

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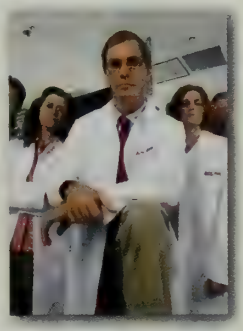

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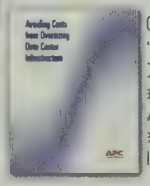

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You Are What You Post

Bosses are using Google to peer into places job interviews can't take them

EDDIE GUY

BY MICHELLE CONLIN

ONE DRIZZLY NIGHT IN Seattle in 2001, Josh Santangelo was hanging out on his computer, clicking through an obscure Web site called Fray. After reading a post that asked if anyone had ever had a bad drug trip, the 22-year-old straightened up and began banging away. "Actually yes, about 36 hours ago..." he wrote. "Two Rolls Royces and four hits of liquid later, I was at a Playboy-themed birthday party with a head as dense as a brick.... It's hard to say no," he explained, "when a pretty girl is popping things into your mouth."

That was back when Santangelo was an up-all-night raver in giant pants and flame-red hair. Today he's a Web development guy with a shaved head who shows up at meetings on time and in khakis. Clients have included such family-friendly enterprises as Walt Disney and Nickelodeon, as well as Starbucks, AT&T, and Microsoft. You can read all about it if you Google him, right alongside the bold-faced entry: "Josh Santangelo on drugs and..."

Oh, the horror. Shortly after Santangelo's late-night overshare, famed blogger Jason Kottke linked to it on his site. That bagged so much traffic that five years later the "drug dump" still ranks No. 7 out of a total 92,600 Google hits that come up when you type in Santangelo's name. He says with a half-laugh that so far "it hasn't hurt me too bad," but he fears for the MySpacing, YouTubing, Facebooking masses—the bloggers and vloggers (video bloggers) who fail to realize that there is no such thing as an eraser on the Internet. "I see people do that sort of thing now, and I think: 'Oh man, that could come back and bite you.'"

Do you give good Google? It's the preoccupation du jour as Google hits become the new Q ratings for the creative class. Search engines provide endless opportunities for ego surfing, Google bombing (influencing traffic so it spikes a particular site), and Google juicing (enhancing one's "brand" in the era of micro-celebrity). Follow someone too closely and you could be accused of being a Google stalker. Follow yourself too closely: Google narcissist.

But Googling people is also becoming a way for bosses and headhunters to do continuous and stealthy background checks on employees, no disclosure required. Google is an end run around discrimination laws, inasmuch as employers can find out all manner of information—some of it for a nomin that is legally off limits in interview age, your martial status, the value house (along with an aerial photog it), the average net worth of your bors, fraternity pranks, stuff you v college, liens, bankruptcies, politic iations, and the names and ages

PLAYBOOK: SMART STRATEGIES

Managing Your Digital Doppelgänger

Your current boss and future employer have a new best friend in Google. Some tips to clean up your digital dirt:

1 Register with an online profile manager such as Ziggs or LinkedIn. They're free.

2 If yo MyS from risqué; cons or using an

n. Former Delta Air Lines flight at- Ellen Simonetti lost her job be- he posted suggestive pictures of n uniform on her "Queen of Sky" ven though she didn't mention the y name. "We need Sarbanes and come up with a Fair Google Re- Act," says Brian Sullivan, CEO of

recruitment firm Christian & Timbers. "I mean, what the hell do you do if there is stuff out there on Google that is unflattering or, God forbid, incorrect?"

Not a whole lot. That's because today there are two of you. There's the analog, warm-blooded version: the person who presses flesh at business conferences and interprets the corporate kabuki in meetings. Then there's the online you, your digital doppelgänger; that's the one that is growing larger and more impossible to control every day.

Because anyone, anywhere, at any time can say anything about you on the Web, reputations are scarily open-source. And because entire companies dedicate themselves to recording every inch of information on the Web, it's becoming difficult to unplug from the Google matrix, let alone make anything on the Internet go away. "This takes people's own agency out of how they want to present themselves," says Alice Marwick, a technology consultant and PhD candidate in New York University's Culture & Communications Dept. The Internet started out with avatars and anonymity. Now online and offline are bleeding together. "It's consolidating personal information into the aggregate," says Marwick, even though "our social practices haven't figured out how to keep up with the technology."

MySpacers don't see how their frankness could backfire

Search engines make it possible for employers to scour all manner of digital dirt to vet employees. Online profile company Ziggs.com CEO Tim DeMello fired an intern after he discovered that on the intern's Facebook profile he divulged that while at Ziggs he would "spend most of my days screwing around on IM and talking to my friends and getting paid for it."

There's also the risk of having no hits at all. (Translation: You are not a player.) Or the risk of having one too many. For lawyers, Google is paradise, often delivering more damning information than the discovery process does. Employment attorney Eric C. Bellafronto was recently on the phone with a client who had an employee with a history of being MIA. The slacker's excuse that day was that he was in Arizona taking care of a sick grandmother. While talking to the client, Bellafronto Googled the suspected faker and up came the fact that he was in Sacramento, being arraigned in federal court.

"PEOPLE CAN SEE EVERYTHING"

SCHOOLS ARE WARNING parents about Google's danger to the MySpace generation, for whom the Internet functions as a virtual diary-meets-barstool confessional. Adolescents try on identities and new behaviors like sweaters. Only now they are trying them on in front of the world. A Pew Research survey found that more than half of all online teenagers are ripping, mixing, and burning their own content, usually placing their creations right alongside their names and photos. The teenagers on the "companies and co-workers" section of MySpace who are talking smack about employers like Blockbuster, Target, and Gap are clearly unaware of the implications. "People need to realize that this is like putting stuff up on the 6 o'clock news," says employment lawyer Garry G. Mathiason, a partner at San Francisco's Littler Mendelson. "Once you've opened the drapes, people can see everything. They can see your past life."

That's why Dave Fonseca, a senior at the University of Massachusetts, pulled his Facebook profile down in December. "Employers are looking at these things," he says. (It's easy for people to get passwords and noodle around on the site.) Fonseca even knows the verb for people who get fired for what they put on their Web sites: "dooced." The name comes from Dooce.com, the blog of Heather B. Armstrong, who got canned after writing about her job on her blog. Even Friendster, a social networking site that thrives on getting people to reveal everything about themselves, has been insistent on old-school discretion in-house. The company terminated esteemed engineer Joyce Park 18 months ago for mentioning Friendster on her blog, Troutgirl. The rumor on the Web was that the offending entry referred to Friendster's earlier sluggish performance. But the info was already widely known.

Oh, the irony. ■

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4 Think before you blog. Anything personal that you post may come back to haunt you.

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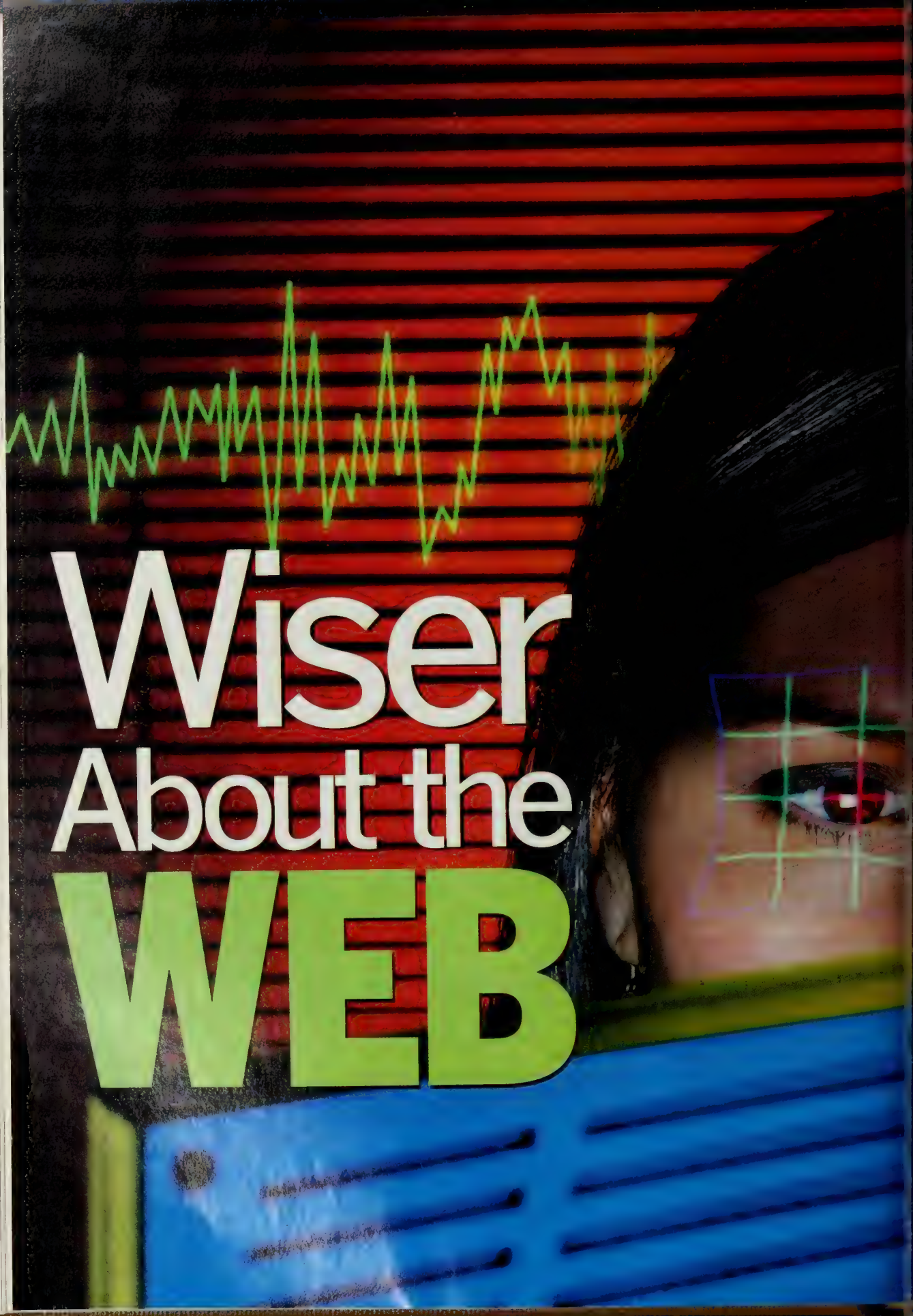
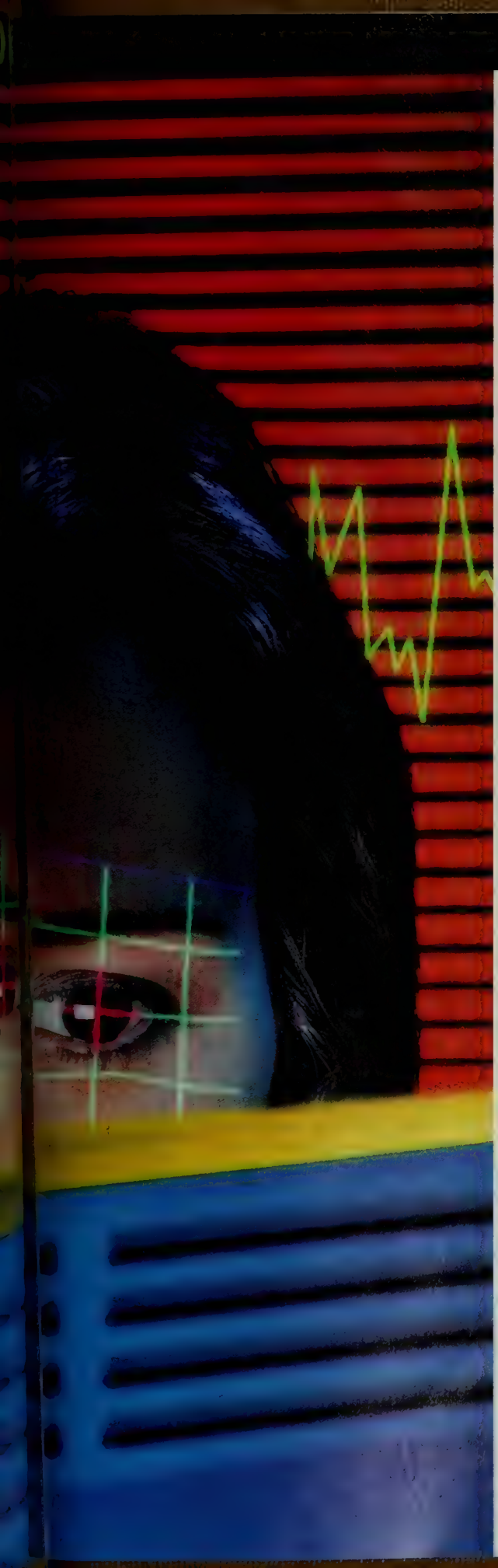
SPECIAL REPORT THE FUTURE OF TECHNOLO



Wiser About the WEB



As companies get savvier about where to place their ads, there's a flight to quality

BY STEPHEN BAKER

COUNTING. THAT'S ONE SKILL COMPUTers mastered from Day One. Their knack for numbers has helped turn the Internet into an advertising sensation. No medium before has been able to provide advertisers with such detailed information on how many people see an ad—and how many respond to it with a click.

This apparent precision has helped hoist Google Inc. into the stratosphere. And it has powered phenomenal growth across Internet advertising, from banner ads on smart-alecky blogs to movie videos jumping out from Yahoo!'s home page. Net ads rose last year from $9.6 billion to $12.5 billion, according to PricewaterhouseCoopers. And now the other media, from TV to magazines, are scrounging for ways to measure their audiences and come up with more numbers of their own.

But not all the Internet numbers tell the truth. The same technology that's smart enough to target ads automatically, and to count them, can also be engineered to churn out false clicks by the millions. Google, for one, has agreed to reimburse advertisers plagued with fraudulent clicks since 2002 for as much as $90 million.

And cyber scoundrels aren't the only ones messing with numbers. Concerns about privacy are leading an estimated 10% of Web surfers to erase their Internet cookies on a regular basis. These little bits of code dropped into computers by publishers and advertisers carry out useful chores, like remembering passwords and preferences. For advertisers, they provide the kind of detailed customer information that makes the Internet irresistible. Add up the click fraud and the erased cookies, and it may look as though Internet advertising is facing a counting crisis.

Those players who win the trust of their visitors will emerge as the Internet elite

What's an advertiser to do? That's easy. Keep counting.

The race is on to find new ways to track customer behavior. Advertisers and agencies are progressing far beyond the standard arithmetic of counting clicks and page views. They're tracking the to-and-froing of the mouse on Web pages, and they're finding new ways to group shoppers by age, Zip Code, and reading habits. CEO David S. Rosenblatt of DoubleClick Inc., which serves up some 200 billion ads a month for customers, says that every campaign now allows for 50 different types of metrics. One New York advertising company, TACODA Systems Inc., is set to wire a group of Web surfers with brain scanners to see which ads register in their minds.

PHOTO ILLUSTRATION BY MICHEL TCHEREVKOFF

This flood of new measurements is likely to roil the Internet ad industry. Until recently, the data have primarily shed light on the ads customers see and click. But the details pouring in are sure to provide a far more thorough understanding of the Internet players themselves: which ones assemble the best overall portraits of customer behavior, and which ones fall short. Rishad Tobaccowala, chief strategist at Publicis Groupe and head of a consulting startup within the company, Denuo, predicts that the new data will lead to dramatic stratification in the industry. "You're going to see a flight to quality" in Net advertising, he says.

Tobaccowala and others predict the rise of a small and exclusive online elite. These will be sites that manage not only to attract flocks of faithful customers but also to entice them—with a combination of trust, high quality, and smart promotions—to share their data. One brick-and-mortar model for this is the supermarket customer loyalty card, with which grocery shoppers fork over details on their shopping patterns in exchange for discounts.

BANNER vs. SEARCH ADS

INTERNET PLAYERS WHO WIN SIMILAR TRUST AND POPularity could command premium rates for advertising and related services. Below them, in Tobaccowala's view, a vast contingent of competitors will sell ads at commodity rates, the online equivalents of pork bellies and West Texas crude. The battle ahead in every branch of Internet advertising is to gain a foothold among the ruling class.

Online advertising breaks roughly into two camps. The fastest-growing side has been search-engine advertising, led by Google and Yahoo. This industry has zoomed from zero to an estimated $5 billion in six years. The process starts as advertisers bid for keywords, whether "Viagra" or "Miami hotels." When a Web surfer enters those words, their ads show up alongside the search results. And they pay an agreed price to the search engine every time the ad is clicked. When it works, search provides such rich data that advertisers can calculate minute by minute the return on investment for each keyword. It's an unprecedented level of accountability—provided the clicks are real. Last year search-related advertising was on pace to grow 27%, as was the competing camp, display ads.

But advertising executives predict that the display banners and videos that appear on Web pages will outpace search this year. "Most of the big money [advertisers]—cars, movies, packaged goods—are putting mo their budgets into display," Jeff Lanctot, general mana agency Avenue A/Razorfis world's largest buyer of Int ads. "We think growth in s will fall back in '06." Go chief financial officer, G Reyes, hinted much the when he indicated on Fe that Google's per-cust growth in search adver had topped out, triggering vestor stampede.

As brand advertisers into display ads, they're gry for new measuren With the page view as its dard metric, display ha ways been far less accou than search. Sure, Web can count the times an ad up on a page someone But how many of the re actually focus on the ad? ies show that they take i an average of one of ev Internet ads. What's m display advertising, eve more concrete metric of is questionable. " measurement has abused," says Greg S president of the Inter Advertising Bureau in York, an industry group. "There's no relationship be clicks and brand awareness."

Some 18 months ago, Stuart's group set out to quant value of Internet ads and to compare them with advertise in other media. The agenda was clear: to attract advertiser were placing only about 3% of their budgets online. The ing IAB studies, which involved 30 major advertisers, inc Procter & Gamble, Kraft Foods, and Ford Motor, used testing methods similar to those of social scientists. They created control groups, exposed them to mixes of advertisements from various media, and tracked their effects in recall, brand recognition, and intent to purchase. The IAB concluded that most of the advertisers were underspending online—and advertisers agreed. Ford, which was spending less than 5% of its ad budget online, quickly moved to triple it.

A banner on a leadi portal suc as Yahoo or MSN can run $500,000 per day

The ideal is not only to reach viewers but also to get them to spend time with the ad—and si advertisers what interests them. Clicks achieve that, bu surfers are wary of detours and fearful that unknown site infect their computers with spyware. This has led advert their latest wrinkle: measuring the movements of the New interactive banner ads spring to life when the Web crosses them with the cursor. No click necessary. Some c

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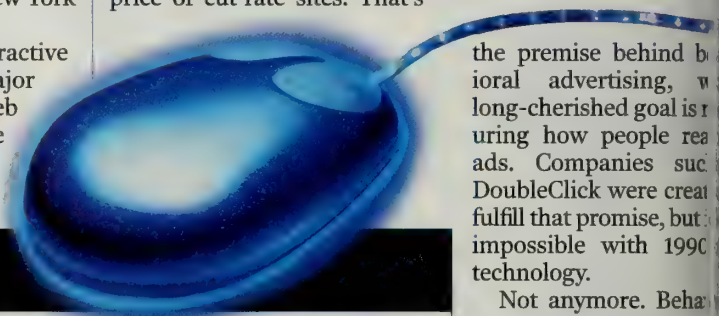
balloon into mini Web pages as you browse. Others sprout arms and legs pitching cars or recipes.The advertisers don't always know who the Web surfers are, but they often know which Web page they have come from. They can track which parts of the banner appear to interest visitors and how long they spend there. This contributes to an avalanche of data. "We have so much data that agencies are hiring teams of analytic people, PhDs in statistics, to make sense of it all," says Greg Rogers, director of strategy and insights at MEC Interaction, a New York media agency.

Kraft Foods builds entire campaigns around interactive banners. Before holidays, it serves them up on the major portals like MSN.com and Yahoo's main page. Web surfers whose cursors pass over these banners are served recipes featuring Kraft products. This feature enables Kraft to gauge the popularity of each food.



BEYOND CLICKS

Internet advertisers are coming up with far more sophisticated methods for tracking customer connections. Here are a few:

MOUSE MEANDERINGS Rich banner ads change as readers cross over them with their cursors. New technology can tell advertisers how long readers hover over each section of the ad—even if they never click.

BRAIN WAVES TACODA, an advertising technology company, is studying the eye movements and brain activity of 30 Web surfers. The idea is to see which ads grab the viewers' attention.

FOLLOWING THE BUZZ Tech consultancies such as BuzzMetrics, Umbria, and Brandimensions are keeping tabs on blogs and social networks to evaluate the response to ad campaigns and product launches. They can target groups based on age, geography, and interests.

DASHBOARDS With new control monitors, advertising teams can check the performance of their online ads in real time. This permits them to tweak the content, mix, or placement day by day.

Advertisers and agencies now monitor the performance of their online ads with so-called computer dashboards, which allow them to track their portfolios of ads. Like social scientists, they test ads against "placebos," usually a give-away ad for a charity such as the Red Cross. If one ad fares better than another against the placebo, they make adjustments on the fly.

PRIME NET REAL ESTATE

AS ADS SPEW OUT MORE DATA, THEIR VALUE rises. According to Avenue A/Razorfish, a banner on a leading portal, such as Yahoo or MSN, now costs about $500,000 for a day, about the same as a 30-second spot on a hit TV series such as CBS's *CSI*. Some 20 million to 25 million unique visitors stop by while the ad is up. These spots are so hot that the portals, like TV networks, sell them long in advance. And as a condition for prime real estate, portals demand that advertisers buy inventory on their less popular pages.

Joanne Bradford, MSN's chief media revenue officer, believes the flight to quality is already under way. "The niche sites are going to have a harder time competing," she says, predicting that the demand outside the elite "will start cooling off in 18 to 24 months." At the same time, leading niche sites, blogs, and social networking pages can take advantage of their relatively low prices and targeted audiences to attract advertisers. To join the elite, however, they will have to provide advertisers wi liable numbers. For this, many are already piling into ass tions that can vouch for a level of quality and provide uni metrics. Burst Media LLC, for example, offers advertisers a to nearly 2,000 Web publishers in 407 different categ "Small sites provide the targeting advertisers want," says CEO G. Jarvis Coffin III.

But what advertisers really want is premium targeting price of cut-rate sites. That's the premise behind b ioral advertising, w long-cherished goal is r uring how people rea ads. Companies suc DoubleClick were creat fulfill that promise, but impossible with 1990 technology.

Not anymore. Beha agencies such as TA and Revenue Science the online sessions of surfers. By tagging with a cookie when the it one of the agency's sands of affiliate site system can follow a surfer, say, from Yah popular auto site Aut Inc. to an obscure hobb on winter gardening. the agency's comp don't know the surfer's tity, they can deduce the stop at Autobyte they're dealing with a potential car buyer. But that site is p and lots of other car ads jostle for the viewer's attention. behavioral system hits the viewer with a car ad when he's much cheaper gardening site. It's a form of advertising arb making money on the spread between premium relevant ments and cheap sites. This approach accounts for 8.3% ternet spending volume today, according to eMarketer In

For behavioral targeting to continue growing, the agencies must provide advertisers with more numbers. That's where the eye-and-brain scan comes in. In tests late last year, TACODA's researchers recruited 30 human guinea pigs at malls in New Jersey and Southern California. They hooked them to an eye-scanning camera and recorded every darting movement as the subjects were shown 50 identical Web pages. The result: The ads placed on pages unrelated to the advertisements' message actually attracted 17% more looks. To see if the messages sink in, TACODA is planning brain scans.

Businesse can calcul minute by minute, th return the get from their sear engine ad

It has always been the goal of advertisers to work insi minds—mainly to get their message in. Increasingly, the k measure the responses and gauge what happens next. ■

–With Jessi Hempel in Ne

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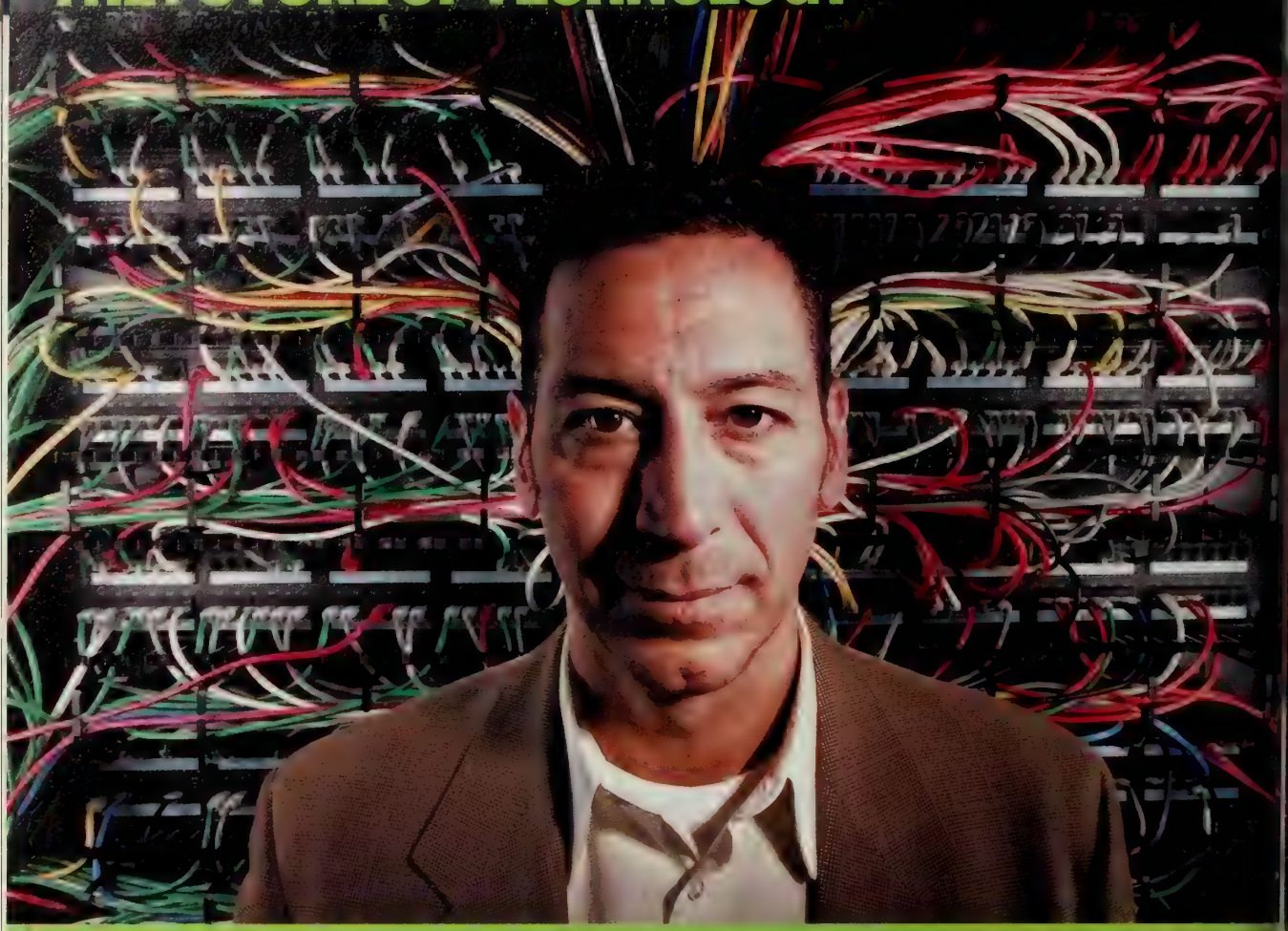

TV EYEBALLS Close-Up

A handful of companies are figuring out how to give advertisers better feedback on who's watching

BY TIMOTHY J. MULLANEY

EVER SINCE THE ADVENT OF COMMERCIAL TELevision, advertisers have wondered exactly what they get for the megabucks they spend on 30-second spots. After all, the networks and cable companies offer only a crude approximation of who is watching what. With such thin information, advertisers can't target specific neighborhoods or consumer tastes. As for converting ads directly to sales, well, that's virtually impossible. Yet the Web, with its sophisticated per-click metrics, does all of that billions of times a day. "The problem," says Yankee Group analyst Aditya Kishore, "is that there's not enough math in [the TV] business."

But aQuantive Inc. aims to change that. A marketing firm that also owns the Avenue A/Razorfish Web ad agency, aQuantive helps clients measure online audiences and tailor ads to specific surfers. Having locked up a sizable chunk of that business, the Seattle outfit is eager to bring its smarts to television, promising advertisers their first real fix on the viewing and spending habits of Americans. Why get into TV? Despite the hoopla about advertisers moving online, the $70 billion television ad market dwarfs the Web business 5 to 1. Says aQuantive Brian P. McAndrews, once an ABC executive: "TV is the la medium out there."

Atlas on Demand plans to harvest informati from viewers' set-top boxes

It's only one of several companies figuring out new wa measure TV viewers and their habits. Ratings giant Nielsen dia Research plans to have its own system in place by the e '06. Rentrak Corp., an entertainment industry information ice, provides viewer data to programmers. TiVo Inc. already t its subscribers. This flurry of activity won't transform TV over though. The measuring technology remains immature, inter TV is in its infancy, and the cable companies are loath to anno tomers by sharing their viewing habits with advertisers.

That's why aQuantive is taking baby steps. Starting in the company's Atlas on Demand unit will begin testing tec

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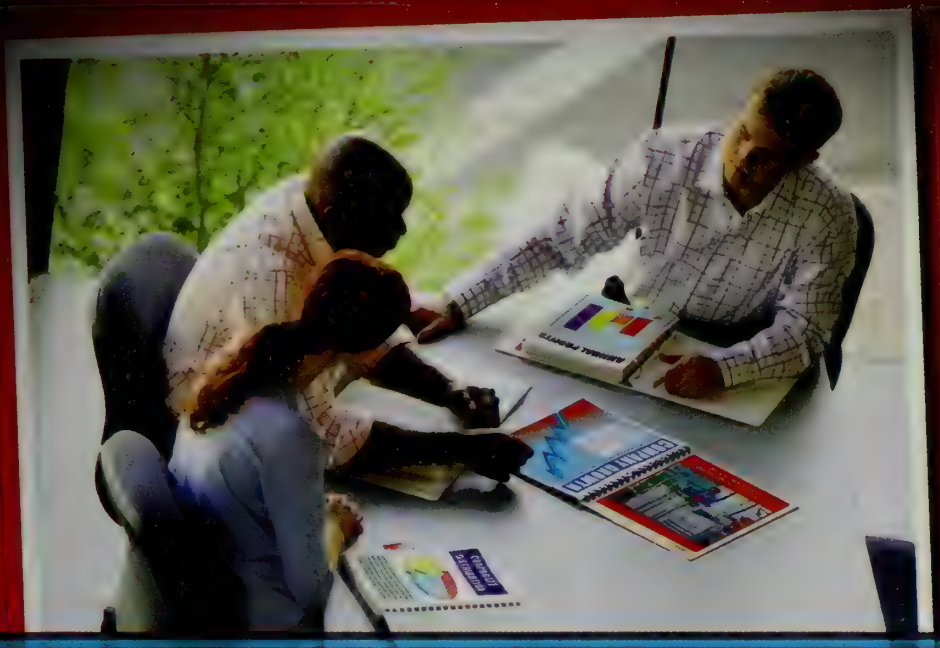
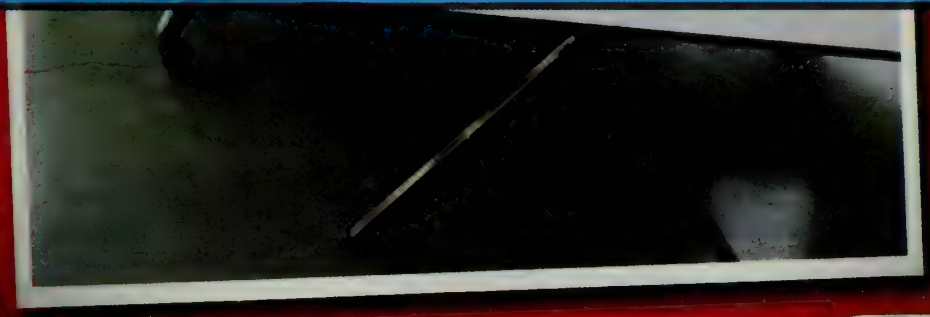


Any MFP can print colorful growth charts. How many can actually help you achieve them?



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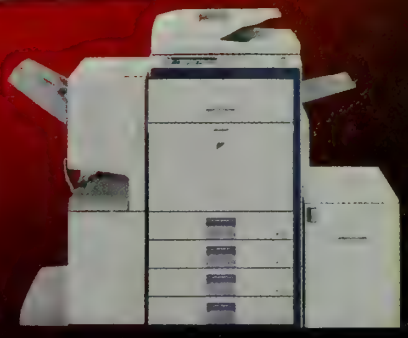

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ogy that measures video-on-demand (VOD) viewers for Charter Communications Inc. VOD's Web-like interactivity is what sold aQuantive. Besides, the medium is taking off, with digital cable now in 25 million homes, far ahead of TiVo's 4.4 million.

By gathering data from the same set-top boxes viewers use to order shows and movies, Atlas on Demand plans to figure out how many people watched a show and when, as well as how many watched the ads vs. skipped them. From there, company executives hope to help advertisers determine precisely how much attention their money buys. "You know people watch *Lost*," says John Chandler, Atlas on Demand senior analyst. "[Now] you'll know if they watch the ad."

Assuming the technology works, by late 2007, Atlas will be able to tell advertisers which ad to put in which show and how to target the spot to each viewer. When someone orders a *Law & Order* rerun, say, Atlas on Demand will take into account what time of day he watched it, other shows he views, and the demographics of his neighborhood. Then it will tell the cable company which ads to splice in. The system "lets advertisers find people when they're receptive," says Scott Ferris, who runs Atlas on Demand.

THE SEARCH FOR TOMORROW'S VIEWERS

Since TV was invented, advertisers have known half of their spending is wasted. Taking a page from Web advertising could improve their returns—and change television as we know it

COUNTING EYEBALLS Companies such as aQuantive aim to tell advertisers much more about who watches each show: which people, for example, view ads vs. fast-forwarding through them. The goal: to provide quantitative ratings for micro-audiences.

MIXING IT UP Kohler, Kraft Foods, and others are experimenting with new ads for emerging TV content such as video on demand. Instead of 30-second spots, they're trying everything from five-second ads to long-form videos that provide product info—a car's specs, say.

MICRO-SLICING Instead of showing the same spot to all viewers, ad agencies hope to match ads to where viewers live and when they watch a show. Someday ads could be targeted even more narrowly according to viewing habits and interests, although privacy laws have cable companies holding back.

CLICK AND BUY Advertisers soon hope to offer coupons and discounts to viewers or allow them to order a pizza and bill it to their cable account. Over time, ads could be priced based on how many people buy something, rather than how many viewers watch the show.

TECHNICAL GLITCH

PROPONENTS OF VOD HOPE THE MEDIUM will become as interactive as the Web itself, allowing viewers to get discount offers, enter contests, and even buy stuff. Burger King is considering running ads offering drive-through deals to late-night VOD viewers. Such ads could be priced based on the number of leads or sales they generate rather than the number of viewers they attract. "The intersection of video on demand and interactive TV is the next frontier," says Time Warner Cable Executive Vice-President Peter C. Stern. "I look for it to emerge in 2007."

Will all the pieces be in place? Converting its Web technology gives it a head start, says aQuantive. But Atlas on Demand remains a work in progress. Ferris acknowledges that his technicians managed the first test exchange of data with a cable company only weeks ago. When his team tried to demonstrate Atlas on Demand for *BusinessWeek*, it wouldn't run on two separate occasi

Technical bugs are thing. Creating ads tailor smaller slices of the audi will also require a major s egy overhaul on the part o vertising agencies. They' ready trying everything 15-second spots designed over before viewers reac the zapper to 18-mi videos on bathroom d sponsored by Kohler Co.

And while the nationa petite for on-demand gramming is growing many advertisers remai willing to commit big d to the emerging medium. rester Research Inc. says commanded a minuscul million in ad revenue 2004, the only year for w numbers are available.

A catch-22 is at work vertisers won't get deep VOD until Big Cable pro more metrics. And the companies are loath to di information about indiv viewers for fear of viol privacy regulations that date the Internet. "We w generate additional reve says David Porter, direct new media business developme Cox Media, "but not at the cost of a ing our customers."

To get around the privacy issue, says, Atlas on Demand's first iteration not try to harvest individuals' inform But a version due out at the end of '07 will be looking for more specific data. That will mean persuading viewers—with incentives—that it's worth coughing up personal data. TiVo is a pioneer in this area. It offers subscribers a way to click from a regular spot to a long-form ad and then order a brochure or enter a contest. As many as 15% of viewers who watched an extended ad volunteered their information, says TiVo's national ad sales VP, Davina Kent: "Consumers will click when they're in control."

Advertise won't get deep into on-deman programm without more view metrics

Despite myriad challenges, the cable guys have little choi to become more Web-like. Every other day, it seems, mar launch of yet another ad-supported online channel. Siebrecht, Atlas' general manager, bets Web video will bec major ad market sooner than VOD, but he says on-dema eventually will be bigger. He and the other Atlas folks don whether the next great video market is TV or the Web. The to make money either way. ■

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After Icahn's Exit

With the battle won, Dick Parsons focuses on Time Warner's stock—and his own future

IN HIS FOUR YEARS as head of the world's largest media company, Time Warner Inc. Chairman and CEO Richard D. Parsons has faced one crisis after another. His latest management win: reaching a settlement with formidable billionaire investor Carl Icahn, who for months vowed to oust Parsons and the rest of the Time Warner board and break the company apart. Still, Parsons' biggest challenge remains boosting the share price, which has been stagnant for three years, at around $17. In his first extensive interview since the Icahn deal, Parsons spoke with *BusinessWeek* Editor-in-Chief Stephen J. Adler about his battle with the former corporate raider, the plight of his shareholders, and a career beyond Time Warner. The two sat down on Mar. 9 as part of the Captains of Industry series at the 92nd Street Y in Manhattan. Edited excerpts from their conversation follow:

Do you come out of your battle with Icahn a winner or a loser?
We come out of it in a good place for the company. In terms of so-called concessions to Mr. Icahn, we didn't really do anything that we weren't prepared to do in the best interests of shareholders. He and I agreed on one thing from Day One: that the company is undervalued. [But] I don't want to suggest Carl didn't have any impact on our thinking, because he did. He got us to focus in a more intense way on what we, and our shareholders, are interested in.

Just how distracting was Icahn to you?
[His campaign] got to be more of a distraction than was useful, that's for sure, because it was s sport in the newspap Before we finally deci everybody should down their war cl and resolve this thin was taking up 30% 40% of my time.

What do you say to lo term shareholders wh saw their stock go up nearly $100 in the lat 1990s, down to the $ range at the time of th AOL deal, and now se stuck at about $17—h do you frame that for shareholders?
[Those] who took ride don't need m frame it for them. T are pretty plugged i their own experie Nothing you can do, can do, can change t We all suffered. Th sue is where do w from here. How do build the value b How do we re-create only the reputation the excitement that here?

Wouldn't it be comforting for peopl at this point to hear you say the AOL merger was not the right thing to do, b it was a mistake?
Well, what I have said in the past, what I say now, is clearly the timing inopportune. If you want me to say timing was a mistake, I'll give you th

What is the significance of Google purchasing a 5% stake for $1 billion in America Online?
We will be able to leverage mor Google's technology on the AOL platf And we want to deepen our partner with Google on certain kinds of adve ing. For Google, mainly [CEO] Schmidt, they wanted to invest more. They think that AOL's fu prospects are that strong.

Do you see a repeat of a bubble in the valuation of Web companies?
The Internet has barely gotten int teenage years, and there is a lot mo front of us. But there will be many competitors for the space, and growth rates will be less robust. I t

round the beginning of the 20th century, society emerged from the late 19th century era of industrialization made the transition into one of rapid anization. The ensuing trend toward ation was in response to the social of the times, and it was propelled by a focus on productivity and efficiency. ast wave of industrialization and then ation culminated in today's IT revolu- d accelerated globalization.

ecent decades though, social needs volved, and people are thinking more the quality of personal and working les as well as more about the issues hind by industrialization. Many have the question, "Technology—For " The answer seems to be that so- oday wants more emphasis on devel- and applying technologies that reflect eration for people's aspirations and gs as well as technologies that put emphasis on harmonizing relation- between machines and people, en human beings and nature, and n the drive for efficiency and the r creativity.

OMRON, however, we have always d that a new era would come, the era 'optimization society," when people e again put first and where security, the natural environment, and health e highest priorities. Our company s best summarized by the words of nder, Kazuma Tateisi, who wrote in "At work for a better life, a better or all." He was convinced that com- should stand for something more fit generation. They should look to benefit as the compass for guiding ategies and be proactive contribu- making a better life for all through siness activities.

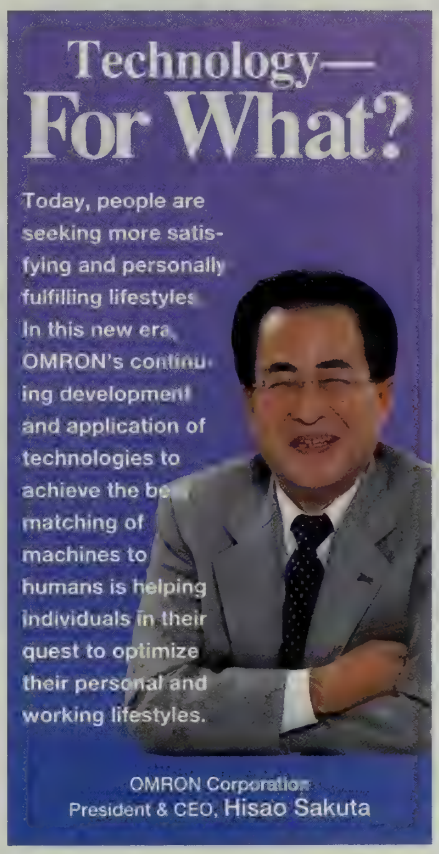
ughout its history, OMRON has used on identifying social needs ating products that promote secu- ety, the environment, and health.

in with its company motto, virtually ts founding in Japan in 1933, RON has focused on being sensitive to tifying social needs as well as creat- ducts that contribute to fulfilling dreams for security, safety, a sus- natural environment, and health. mization society now emerging will cterized by more focus on the indi- nd people worldwide will put more s on attaining lifestyles that are both g and psychologically fulfilling.

With social benefit as its compass, RON has created many value-added s over the years. A key theme RON has always been assisting turers in automating production s to enhance product quality and create a workplace where the tasks that machines can do are left to the machines, allowing human beings to pursue more creative and exciting tasks.

OMRON's main businesses are industrial automation, electronic components, automotive electronics, social systems, and healthcare. In each area, the key theme is growing and developing by satisfying social needs.

OMRON has grown its businesses by anticipating the potential needs of society and developing products based on its core sensing and control technologies to meet those needs. Through continuing R&D in the fields of sensors, control systems, and



human behavior, OMRON has perfected sensors that exceed the capabilities of human vision and control technologies that approach the level of human knowledge and judgment.

In our largest business, industrial automation, we are Japan's foremost manufacturer of control equipment for automating factory processes and make important contributions to improving productivity, profitability, and the quality of work life in many industries. To build this strong position in industrial automation, we have worked closely with our customers to explore new possibilities and bring their ideas to life through socially responsible manufacturing. Our approach is always to bring our customers the latest thinking in sensing and control to help them be quicker, more efficient, and smarter. Our goal in industrial automation is to bring new possibilities to life in manufacturing every day.

In our automotive electronics business, too, we are striving to realize new possibilities as we work toward another of our long-held dreams for society—creating a world free of traffic accidents.

Preventing collisions is a desire shared by motorists, car manufacturers, and pedestrians in countries across the globe. In response to this social need, our automotive electronics business, another of our major business segments, has devoted many years to perfecting a high-performance laser radar for use in intelligent cruise control systems.

In brief, our laser radar system emits a beam of light forward from the vehicle. As it bounces off vehicles or other objects, OMRON's sensing and control technologies go into action to compute the distance to the object. The technology has high detection sensitivity, and a two-dimensional wide detection area unlike any currently available systems, enabling accurate operation at most times of day, even in smoky, foggy, or dusty conditions. Incorporated into intelligent cruise control systems, this laser-based system can provide vital assistance to drivers in preventing collisions.

We committed ourselves to developing this laser radar over rival technologies because its lower cost means that car manufacturers can meet the needs of an even wider market, making it optimal from both a business and a social standpoint.

We at OMRON think the answer to the question posed in the title "Technology—For What?" is that technology should satisfy social needs and contribute to the creation of products that enhance security, safety, the environment, and health. Why? First, because in the "optimization society" people worldwide will put more emphasis on attaining better life and work styles. But also because it is just good business—for all our stakeholders. Good evidence of this is that for the year ended March 31, 2005, OMRON's consolidated net sales grew 4.1%, to US$5,687.7 million, operating income expanded 9.2%, to US$524.4 million, and return on equity rose to 10.4%.

More information on all aspects of OMRON's activities is available at
www.omron.com

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you are going to see things cool off a bit.

Why is the market not happy with Time Warner?
It's less specific to Time Warner than it is to our sector. Markets cannot deal with uncertainty, and there is a lot of uncertainty around the future prospects for the Old Media businesses. How are they going to fare and grow in this new digital age? Will piracy hollow out the margins in the content business? The market is saying: "Right now we don't know, so we're staying away."

Time Warner has a huge investment in magazines. Is that business in trouble?
No. It's a very good business. I'm going to quote my friend Warren Buffett. Shortly after I became CEO, everybody had a suggestion on how to fix the company. One was to sell the magazine business. Warren said: "If I were you, I wouldn't sell [it]. But if you do, sell it to me." He said people are going to be reading magazines for a long, long time.

> "Markets cannot deal with uncertainty, and there is a lot of uncertainty around the future prospects for the Old Media businesses"
> *–Richard D. Parsons, CEO, Time Wa*

Are you pleased that Ted Turner is no longer on the board, particularly since he can be difficult to work with?
No. Ted is a character. He has his own way of thinking. But all that said, the man is flat brilliant. Being a board member is a little too passive, too inactive for him. So he wanted to wait until most of the heavy weather was behind us, and now he's off to disarm the world, solve global warming, and sell some buffalo burgers.

Jeff Bewkes is now president and chief operating officer for the entire company after Don Logan announced his retirement. He is the clear No. 2. Is he going to succeed you?
I hope so. That's not my call at the end of the day. That's why you have boards. In my opinion, he's the guy who should.

There has been speculation about your running for mayor of New York. Do you intend to succeed Mayor Bloomberg?
No. I do like public policy, and I hope to find my way back there someday. I don't know that I would run for anything. My focus now, however, is on Time Warner and rewarding our shareholders.

You turn 58 in April. Do you have a concept of what you might like to do after Time Warner?
Actually, I do. I am interested in kids and in education. I think we have arrived at a place where that is the ultimate k self-fulfillment, by allowing a perso realize their own potential to [ach social progress and mobility. I got a education. That enabled me to do p much whatever I set my mind to in That can be most people's destiny they've got to get educated. Somethi that sphere would be of interest.

What impact has race had on your ca
My being African American may disadvantage in that things that have come to you, or opportun aren't as readily made known to yo my case, it's been something of a vantage, though. I think that I hav ways been underestimated. You up, and people—not everybody, many people—just don't expect you've got an A game. I am obvi aware of the fact that I'm African A ican. And I am actually cool with it. I just go do what I have to do.

Do you think it is important for us to h an African-American President?
I do, but I don't think it's as importa having a good President. It will be a er step along the road to a society Martin Luther King envisioned. All firsts move us further down that ro it's important in that sense.

You were an adviser to President Ger Ford. What are your impressions of h
He came across as a guy who was b able, who had integrity, who was try do his best, but who was fallible. He in a sense, quintessentially Ame Within a very short period of time, th fidence of the country in its institut government was restored. I think th deserves huge credit for that. I don't history has yet fully given him th though I think it's coming.

So, is Tony Soprano [the lead charac Time Warner's HBO show *The Sopra* going to live?
At least for the next 20 episodes, or

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SPEED

How smart companies are creating new products–and whole new businesses–almost overnight

STEVE HAMM

LAST YEAR ON FEB. 14, VIRGIN GROUP LTD. FOUNDER SIR RICHARD BRANSON GOT A provocative e-mail out of the blue. Gotham Chopra, son of self-help guru Deepak Chopra, had a proposal: Branson should team up with Indian entrepreneurs who were running a comics distribution business and create a new global comics and animation powerhouse—part Marvel Comics, part Pixar. It fit Virgin's brand: Kids. Fun. Big. Risky. Branson asked his people to check it out. Boom! Bang! Shazam! By July it looked like a done deal, except for one thing. Virgin was moving so fast that none of its executives had ever laid eyes on the operation that was meant to be the heart of its new venture. "I needed to go to India to make sure it wasn't a shack in the jungle," says Virgin Books Ltd. chief Adrian Sington.

It wasn't, and Virgin Comics LLC was born. The company was revealed to the world on Jan. 6, and now Branson and Virgin Comics Chief Executive Sharad Devarajan are sketching

PHOTOGRAPH BY AARON GOODMAN; DIGITAL ILLUSTRATION BY DAVID RUDES/BW

EMONS

PLAYBOOK: BEST-PRACTICE IDEAS

Survival of the Fleetest

Companies on the cutting edge are trying new techniques to help them break their old product-development habits. Here's how they do it:

Find new ways to spot hits

Focus groups and market research aren't enough. So companies are trying new methods to bridge the gap between what technology has come up with and what consumers will want to buy.

Example: Retailer Best Buy has cultivated venture capitalists to find out what startups have in the works.

Launch with agile teams

Large companies should begin new initiatives with small teams and build "fences" around them—so they won't get tangled in red tape. Entrepreneurial outfits are agile by nature.

Example: Restaurant franchiser Raving Brands gets new concepts going with a half-dozen people.

Break your unwritten rules

It's th ties t slow inno And throu bonc

Try brainstorming off-site outsiders who are able to fresh thinking.

Example: Jackson Enterpr a glut of wine, came up wit wine concepts: Both were

out grand plans. They hope to build India into a multibillion-dollar comics market by plying its under-20 population of 500 million with mythic tales. And there may be huge opportunities for export to the West. Seven titles are due out in the U.S., Britain, and India in the coming months. Even animated movies and TV shows are on drawing boards in Bangalore.

Virgin's quick entry into comics spotlights one of the most intriguing shifts in business today. Speed is emerging as the ultimate competitive weapon. Some of the world's most successful companies are proving to be expert at spotting new opportunities, marshaling their forces, and bringing to market new products or services in a flash. That goes for launching whole new ventures, too.

Virgin, which made its name in music, megastores, and airlines, may be the exemplar. In short order, it has entered one new business after another, including mobile phones, credit cards, bikes, fitness clubs, books, hotels, games, trains, consumer electronics, even space travel. "A good idea for a new business tends not to occur in isolation, and often the window of opportunity is very small," explains Branson. "So speed is of the essence."

The pace is picking up across such industries as retailing, consumer goods, software, electronics, autos, and medical devices. In many realms, the time it takes to bring a product to market has been cut in half during the past three or four years. At Nissan Motor Co., the development of new cars used to take 21 months. Now, the company is shifting to a 10½-month process. In the cell-phone business, Nokia, Motorola, and others used to take 12 to 18 months to develop basic models. Today: Six to nine months.

It's all being driven by a new innovation imperative. Competition is more intense than ever because of the rise of the Asian powerhouses and the spread of disruptive new Internet technologies and business models. Companies realize that all of their attention to efficiency in the past half-decade was fine—but it's not nearly enough. If they are to thrive in this hyper-competitive environment, they must innovate more and fa

Of course, speed has been important in business ever s the California Gold Rush. What's changed in recent years is a slew of new techniques make it possible to get things much faster. Start with global outsourcing. A vast netwo suppliers around the world stands ready to do everything manufacturing products to drawing up legal contracts. helps companies create supply chains that are faster, more ible, and more efficient than ever before.

AT THEIR FINGERTIPS

TAKE CLOTHING RETAILER H&M. Every time it designs a outfit, the Swedish company can choose on the fly among than 700 manufacturers worldwide. It looks for the right s geographic proximity, and ability to finish the job quickly— then gets the plant rolling in a matter of hours or days. Or

H&M

It's the Latest Thing —Really

It's 1:30 p.m. on a Monday in the bustling H&M store on Manhattan's Fifth Avenue, and Alma Saldana, a 28-year-old makeup artist from Houston, is stuffing three tiny vests into her black H&M shopping bag. That's on top of blouses, jackets, and pants. Saldana is in a buying frenzy. This is her first visit to H&M, the Stockholm-based fashion retailer, and it's everything she had hoped for. "Somebody told me you find great fashion at a very cheap price, and it's true!" she exclaims.

Such enthusiasm has made H&M Hennes & Mauritz one of the hottest fashion companies around. Central to its success is its ability to spot shifts in demand and respond lightning speed. While traditional clo retailers design their wares at least s ahead of time, H&M can rush items in as little as three weeks. Most of its done ahead, too. But when it sees co scooping up something like vests, it slew of new variations into stores wit same season, to the delight of shop Saldana. "Speed is important. You n a system where you can react in a s time with the right products," says C Executive Rolf Eriksen.

How does it work? H&M designe

ce tasks alists

Design and manufacturing outsourcers don't just do things more cheaply; they do them better sing standard and components, they ent time in half.

l-phone designer s standard designs for ents.

When you have it right, repeat

Once a new product or business has succeeded in the market, don't reinvent the wheel. Look for ways to use the same technology or business model again and again in additional markets.

Example: Virgin launched a mobile service in Britain, then used the template in three more countries.

Wipro Ltd., the Indian outsourcing firm. It does engi- g and design for clients, and in some cases, part of its fee d on the success of the product it delivers. Customers can osts low, until they know they've got a hit on their hands. lients are under a lot of pressure to get new products nto the market. Their core employment isn't adequate o they're looking for partners who can do it for them," im Premji, Wipro's chairman.

n there's technology. The Internet has become ubi- , so companies can connect with talent any- in the blink of an eye, inside or outside the y. Open-source software can be plucked off lf to become the foundation of new soft- rograms or Web sites. Algorithms can be slice and dice market information and w trends.

aps most important, today's fleet companies are embracing a management approach that would have been heresy just a decade ago: If you don't fail occasionally, you're not pushing hard enough. Executives tend to try lots of things, expecting a number of them to flop. It doesn't matter as long as you produce a steady stream of hits. Even losers can burnish a company's reputation for innovation if they're seen as exciting experiments. "It's not just O.K. to fail; it's imperative to fail," says Seth Godin, a marketing expert and author of several books, including *Unleashing the Ideavirus*.

Virgin has had its share of flops. One example: It formed Virgin Electronics in July, 2004, and sold only a modest number of digital music players through that holiday season. Branson, who gets out as fast as he gets in, shut down the business in March, 2005. Google Inc. may be the highest-profile example of the new philosophy. It launches product after product, more than 100 in the past five years. Not all of them soar: one that didn't was Froogle, the comparison-shopping site. Marissa Mayer, who helps guide the company's innovations, says Google wants to try new things and see what resonates with its users. The approach, says Mayer, "frees you from fear."

In this world of possibility, laggards end up losers. The most aggressive companies tap into outsourcers for new products or use the Net to pull in ideas from unknown geniuses in Bangalore or Beijing. Rivals must follow suit or fall behind. The cellphone business is just one sector where the competition is more intense than ever. Motorola came out a year ago with the RAZR, its ultrathin cell phone with camera and music player. Samsung Group answered with the Blade seven months later. Then on Feb. 1, Motorola came back with its SLVR, a phone that's even more svelte than its predecessor. "It's like having a popular nightclub. You have to keep opening new ones. To stay cool, you have to speed up," says Michael Greeson, president of market researcher Diffusion Group Inc.

A higher tolerance for failure doesn't mean ignoring the risks, of course. In certain sectors

uple of cropped vests in their r collections. In August, he vests went on sale, they out of the stores," says den Bosch, H&M's head of designers in Stockholm (it 100) spotted the trend in the rldwide sales reports, rnally every Monday. About mmediately started styles. As quickly as off their desks, pattern d and pinned, pressing o service as live models. At the yers ordered fabrics. The

QUICK TURNAROUND *H&M can go from sketch board to rack in just three weeks*

designs were zoomed electronically to workers at H&M's production offices in Europe and Asia, which then selected manufacturers that could handle the jobs quickly. In less than two months most H&M stores had 5 to 10 new vest styles in stock. "They are the fastest," says Christian Wierup, head of research for Carnegie, a Swedish investment banker. "They're very fast at spotting the trend and getting it out to the masses at a very low price."

One of the secrets to H&M's speed is decisiveness. The people in charge of each collection can dream up and produce new fashions on their own authority. Only huge orders require approval from higher-ups. "We have a flat organization. We have a shorter way to a decision," says Sanna Lindberg, president of H&M Hennes & Mauritz USA. That makes H&M fashionable in more ways than one.

ESSON

ifts in demand

e ur company so you o the market in weeks,

a string of losers can spell trouble. While consumer electronics companies pump out new products at a frantic pace, the industry as a whole barely ekes out a profit. "If you're not fast, you're dead. But if you're not also good, you'll still dead," says George Bailey, a consultant at IBM Business Consulting Services.

Opting out is no option, though. To goose revenues and profits, companies must introduce more products and jump into new markets. There are probably as many good recipes for up-tempo innovation as there are successful companies. No one model works for all industries or even all companies within a single sector. Yet when *BusinessWeek* pinged dozens of companies to see how they do things fast, patterns emerged. Here are some of their best practices for making the journey from concept to market.

FIND NEW WAYS TO SPOT HITS: While focus groups and market research are useful, they're not sufficient. So companies have come up with new techniques for sussing out great ideas. Electronics retailer Best Buy Co. has begun checking with venture capitalists to find out what their startups are working on. Procter & Gamble Co. uses online networks to get in touch with thousands of experts worldwide. That helped the company produce 100 new products in the past two years. One example: It found a professor in Bologna, Italy, who had invented an ink-jet method for printing edible images on cakes. P&G used it to create Pringles potato chips with jokes an tures printed on them—boosting Pringles growth into d digits. "This was terrific. We found a ready-to-go solutio could put into the marketplace," says Larry Huston, P&G's president for research and development. The product came one year, rather than the usual three or fou

KEEP YOUR LAUNCH TEAM AGILE: Ever knows that bureaucracy means death to ideas, yet most companies still insist on fe innovative products and ventures throu gauntlet of presentations and reviews a finements. Not at Raving Brands, an A based fast-casual restaurant franchiser. Ch ecutive Martin Sprock talks a mile a minu launches concepts nearly as fast. In the pa years, Sprock has unveiled six, including Mex, Asian fusion, and gourmet salads, a

37SIGNALS

Programming at Warp Speed

Back in the old days—say, 2003—it typically took a couple of years for a software product to go from bright idea to market. Nowadays? Try months. 37signals LLC, a small Chicago company, has an ironclad rule: Never take more than 3½ months to get a product out the door, not counting holidays or vacations. "This is a new model, not just for building a product but for running a company," says Chief Executive Jason Fried.

In fact, 37signals turns the old ways upside down. For starters, its applications are delivered on the Web for a monthly fee, not sold in boxes. The company's seven employees don't believe in planning, either. They just start creating and trying th And rather than loading products w and whistles, they design them to d things well. "The way to get really go software is to make the simplest thi as fast as you can and get reaction, where it goes from there," says Paul a pioneer in Web-based software an guru for software entrepreneurs wh like those at 37signals.

The story behind 37signals' Back product shows how the company in Fried and two colleagues were at a in Seattle at the end of 2004, gripin the difficulty of keeping track of the meeting, and contact info while on

How to Move into the Fast Lane

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d themselves: Why not handle it ple Web application?

Chicago in mid-January, Fried he project by sketching out what it like. Then he and his colleagues ıext few weeks tapping out ideas on ıuters and firing them back o one another on e-mail hat. It's stressful. One of ers, Ryan Singer, chills out ign binges by twisting o yoga positions.

ıpany takes advantage t Net technologies to ovation. They use a quick- rogramming language called Ruby. Then they tap into a set of premade software pieces, called Rails, which was designed by 37signals programmer David Heinemeier Hansson, to build the foundation of their application. That frees them to spend their precious hours writing code for the parts of their programs that are unique. Ruby and Rails are open-source packages used free of charge by Web developers.

By mid-April the team had created a simple, smooth-functioning application. Fried declared it done, and they stopped adding features—spending the time before a May 3 launch testing the software and building a marketing Web site. Three weeks after the launch, they added a version for cell phones.

There's a downside to this way of doing business. If one upstart can deliver a new product in a snap, so can others. The guys at 37signals aren't sweating it. In fact, between projects they travel the country giving seminars and promoting their book, *Getting Real*, about how they build applications. Unlike many dot-comers who followed the get-big-fast credo, Fried has no plans to add to his staff. The goal: Stay small and agile—and keep pumping out those programs.

INNOVATORS *Fried, Hansson, and Singer (clockwise from left) build Web software at 37signals*

SSON

e a simple ct *as fast as you n get feedback stomers and better.*

er on the way. Raving ls typically goes from ed concept to store ng in about a year. For franchisers, it takes two or more.

ing Brands isn't so a company as a SWAT in chinos and polo Sprock meets with r five senior partners every Monday to handle problems lk over new ideas. They don't have a corporate office, so ather at one of the restaurants. Sprock might come in new concept. (The gourmet salad idea came after he saw salads being custom-made for busy New York office rs.) They'll bat around ideas. Then they'll split up to han- eir specialties—recipes, say, or real estate. If somebody a quick O.K., they get Sprock on his cell. "We take a lot of pride in moving quickly and not having a committee sitting around and planning things," he says.

BREAK YOUR UNWRITTEN RULES: Every company has them. They're those mental crutches that say this is the way we do it because this is the way we've always done it. For routine matters, that's fine. But not when you're trying to create something new, and quickly. There's probably no industry more staid than wine. California's Jackson Enterprises was no exception, until it had to scramble to deal with a huge worldwide glut of wine in late 2004. Rather than pour juice down the drain, the company, known for its Kendall-Jackson brand, decided to do nearly everything differently. "We absolutely broke all the unspoken rules," says Laura Kirk Lee, marketer who led this campaign.

The company created two entirely new brands in a matter of

SHARE YOUR THOUGHTS.

Sun believes sharing is the way to create better ideas. That's why we've teamed up with *BusinessWeek* to offer you an opportunity to share your comments. Join the conversation about this week's Cover Story at businessweek.com/coverstory.

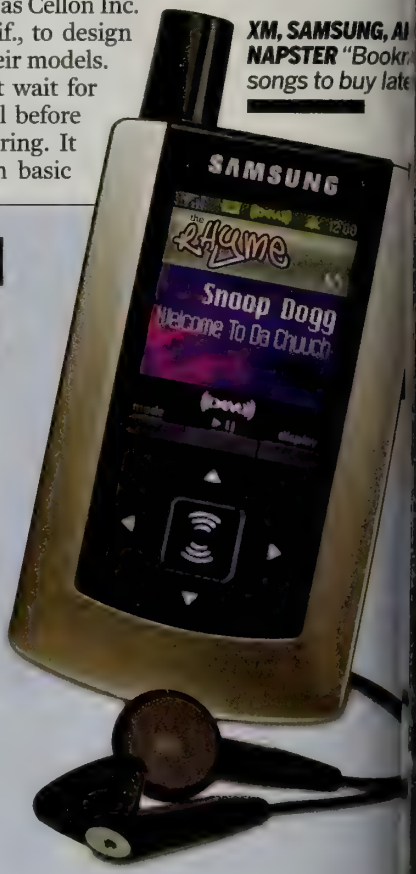
weeks. Aided by design firm IDEO Inc., Jackson Enterprises brought together people from all parts of the business for a weeklong off-site brainstorming session, a first for the company, that shook up managers. In December, 2004, the whole group decamped to Palo Alto, a two-hour drive from headquarters in wine country, for the series of mind-expanding exercises. IDEO did all sorts of things to bring fresh points of view into the discussions, including inviting Stanford students with no background in wine to sit in. One of the key lessons for Lee was rapid prototyping, quickly patching together rough models of wine concepts so the group could see how they looked.

The team emerged from the marathon with 10 crazy ideas, and then settled on two of the less crazy ones. One, named by corporate attorney Tiffanie Di Liberty, was Wine Block, the first wine-in-a-box ever for Jackson. These are elegant, 1.5-liter cubes modeled on perfume packaging. The second was Dog House. These bottles have twist-off tops and a drawing of a dopey dog on the label. The price is $6.99, half that of a typical Kendall-Jackson bottle. Another departure: To get the wine ready for delivery in April, 2005, they operated a mobile bottling plant installed in the back of a semi in the parkin

The results have a hearty bouquet. Jackson expected t about 10,000 cases of each. Instead, both broke the 100 case barrier. The company has an even bolder new vent the works, which is hush-hush for now.

HAND OFF TASKS TO SPECIALISTS: Outsourcing companies just do things more cheaply anymore; they can do them l and faster. Take the cell-phone business. What's in changes as rapidly as clothing fashions, so companies mu troduce a steady stream of new designs. Problem is, it typ takes 12 to 18 months to develop a phone from scratch. why cell-phone companies, both leaders and also-rans, ar ping outfits such as Cellon Inc. in San Jose, Calif., to design some or all of their models.

Cellon doesn't wait for customers to call before it starts engineering. It has a half dozen basic



XM, SAMSUNG, A NAPSTER *"Bookr songs to buy late*

XM SATELLITE

From Handshake to Stores In Just Nine Months

It's hard to imagine a rivalry more intense than that of XM Satellite Radio Holdings and Sirius Satellite Radio Inc., the two satellite radio upstarts. Sirius, of course, paid shock jock Howard Stern $500 million to sign on. Both companies offer hardware discounts and free trials. And both, via hookups with electronics outfits, are racing to be first out with the latest gizmos.

In the white-hot world of digital convergence, where services are increasingly packaged with hardware, partnerships are essential to being first to market with the best blend of services and products. "From now on this will be the normal way of doing business in consumer electronics," predicts Dan Murphy, senior vice-president for sales and marketing at XM.

He should know. XM's alliance with Samsung Electronics Co. to produce the first portable satellite radio combined with a digital music player shows how this sort of thing can be done. In April, XM and Samsung plan to release their co-branded Helix, going from handshake to store shelves in just nine months. That compares with the 12 to 18 months it typically takes to bring new consumer electronics to market. Analysts praise the Helix effort. "You look for markets that are already hot and bring them together," says Michael P. Greeson, chief executive officer at tech consultant Diffusion Group Inc.

How did XM do it? A combination of foresight and a good eye for allies. The journey started in early 2005, when the company spotted the opportunity to meld satellite radio with a music player. Even before it found a hardware partner, XM started designing the building blocks for the machine—including chips, an antenna, and a tiny circuit board. Last May it approached Samsung and discovered that the Korean electronics giant had fixed on the same idea.

Once they signed a deal, the race was on to bring the new device to market. The two companies created a virtual product-development team jointly headed by one manager from each company. Samsung engineers focused on industrial design and manufacturing, while XM focused on the antenna, the user interface, and delivering one-of-a-kind features. Consumers will be able to "bookmark" a song they're listenin to on the radio and later buy it on the Napster Inc. Web site with just a few clicks their computer mouse.

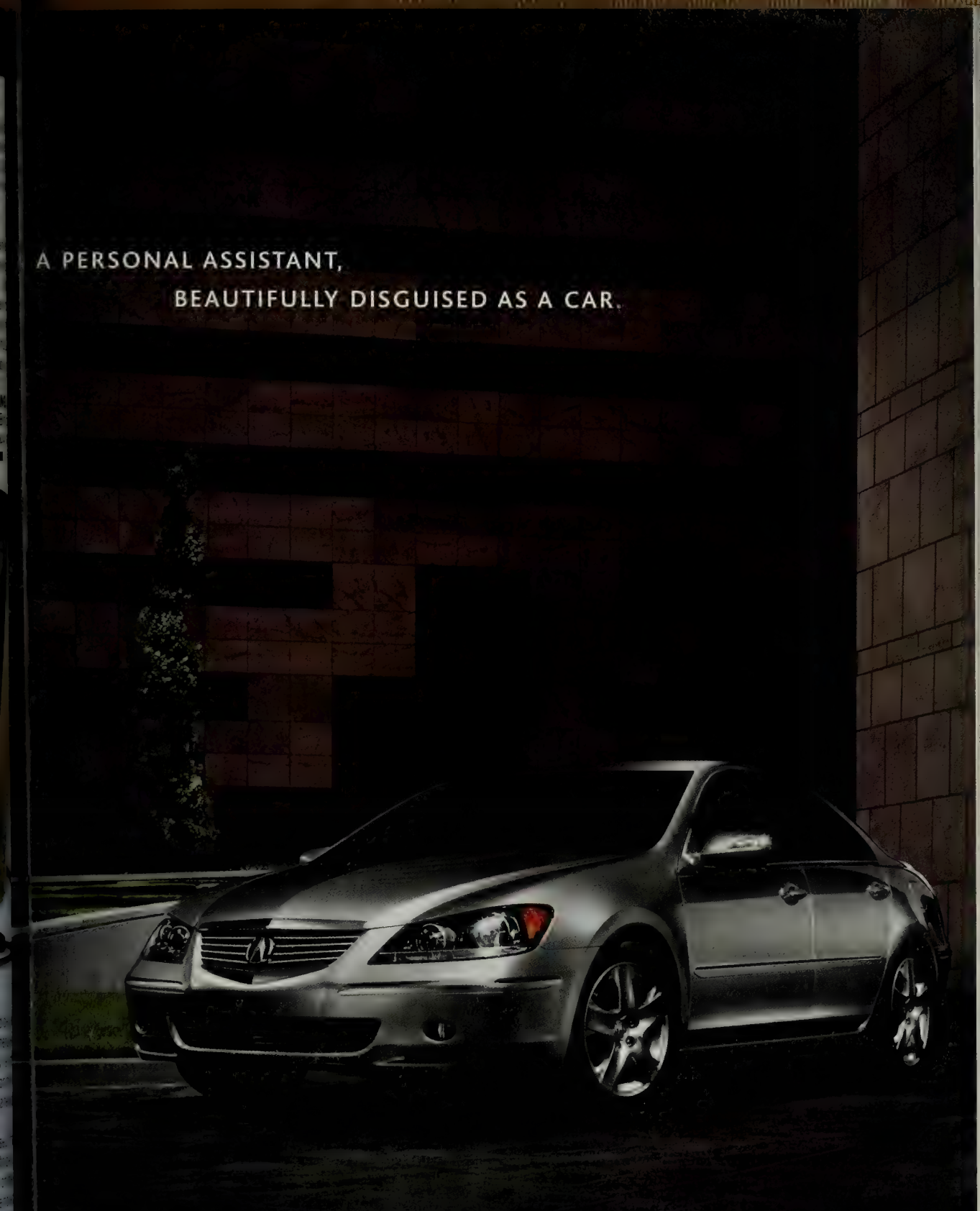
This collaboration marks a sea change Samsung. The company used to be a go-i alone outfit. No more. Now it's on the lookout for more partners. "We have to fin other companies that are leaders in their fields who can move as quickly as we can says Peter Weedfald, a senior vice-preside at Samsung Electronics America Inc.

Will XM and Samsung win this race? It has barely begun. But without alliances t speed products to market, they'd have a hard time competing in this new world.

THE LESSON

***Partnerships are essential** in the world of digital convergence, where services are increasingly packaged with hardware.*

A PERSONAL ASSISTANT,
BEAUTIFULLY DISGUISED AS A CAR.



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BEST BUY

How to Break Out Of Commodity Hell

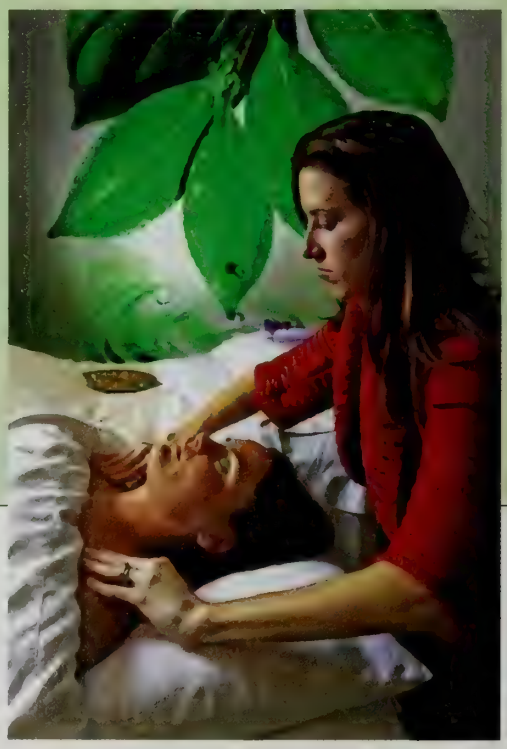
Best Buy Co. looks like the ultimate Big Box consumer electronics store—commodity products at low prices. In fact, the company has been plotting an escape from low-margin hell. It's undertaking a radical shift to improve the customer experience, bring innovative products to market, and generate new retail concepts. "We empower our people to listen and serve, and, at the same time, we go upstream to find out what the suppliers are doing. It's about speed to market. We know what the customers are looking for, and we have a time advantage in getting it to them," says Executive Vice-President Ron Boire.

Nothing about this is business as usual. The company has divided its customers into five distinct demographic groups and is doing extensive market research to figure out how to serve them better. For instance, info gathered in the suburban community of Naperville, Ill., resulted in studio d, a concept store there aimed at soccer moms that sells the latest gizmos and offers classes in how to use them. It's just one of three concept stores Best Buy has launched in the past 16 months, some of which may become new chains. The most offbeat: eq-life shops, where customers can attend a Pilates class, get a massage, and buy health-related tech gear.

Rather than waiting passively for large consumer electronics makers to ship their latest goods, Best Buy has started creating its own. One example: Its Geek Squad service team dreamed up an external disk drive for PCs packaged in its own protective case. Best Buy sketched out a concept for partners to engineer and manufacture. Tim lag: just 120 days from concept to delivery. The company now has a handful of house brands and expects to increase overall margins by 0.5% by 2008.

Another wrinkle: Best Buy has also started tapping tech startups so it can brin the hottest innovations to market. Kal Pate executive vice-president for strategy, meet regularly with entrepreneurs in Silicon Vall and Asia. One recent discovery: Slingbox, $250 device from Sling Media Inc. that lets people pipe TV programming from their homes to their PCs wherever they are. It's brand-new concept. When Slingbox launched last July, Best Buy had a three-month head start on most rivals. That paid off: The company got a close early look at promising new product categor and Slingbox became one of the year's surprise hits.

To quickly incubate ideas, the company runs "accelerated leadership" program that pull together employees from many backgrounds. They're held rooms at headquarters set off fro the bustle of daily business where there's a calming indoor stream and waterfall and even a small cabin for private conversations. Now that's thinking outside the Big Box.



***AAH** Getting a massage at an eq-life concept store*

THE LESSON

***Segment your customers** into distinct demographic groups and figure out how you can serve each one better.*

designs that it can quickly customize for a particular client. These designs include the chips and circuitry for various networks and combinations of features. Cellon, with operations in China, works with nearby manufacturers to prepare its designs for production. It takes just five months to go from design to market. That's crucial. The life span of a cell-phone model is now about nine months. If it takes 18 months to design a product, it's obsolete before it hits the market. In five years, 30 million phones designed by Cellon have been sold by the likes of Haier, Royal Philips Electronics, UTStarcom, and some leading brands it is not allowed to name.

ONCE YOU HAVE IT RIGHT, REPEAT. Virgin took just six months to launch its first mobile-phone service in Britain in 1999. That was mainly because the company arranged with a cell-phone service provider to use an existing network rather than take the time and money required to build its own. Since then, Virgin has begun phone service in three countries using the same model, and it expects to laun three more this year. By usin wireless networks of other co nies, Virgin can concentrate o marketing and customer s that it does best. "It's a tem We'll roll out in a new co every four to five months. It' and lean," says Will Whitehorn, Virgin's development dir

Fast and lean has a nice ring to it, but it's not a claim companies can make. While some organizations have sp up their innovation and formation of new businesses, t the exceptions. Most are still bogged down in bureaucrac old modes of doing things. That's a recipe for trouble. " are two kinds of businesses: the quick and the dead," war alyst Bruce Richardson of tech industry consultancy AM search Inc. That's probably an overstatement. But in an which once-mighty dinosaurs are struggling to survive, ternative to fast and lean may soon be...gone. ■

–With Ian Rowley in

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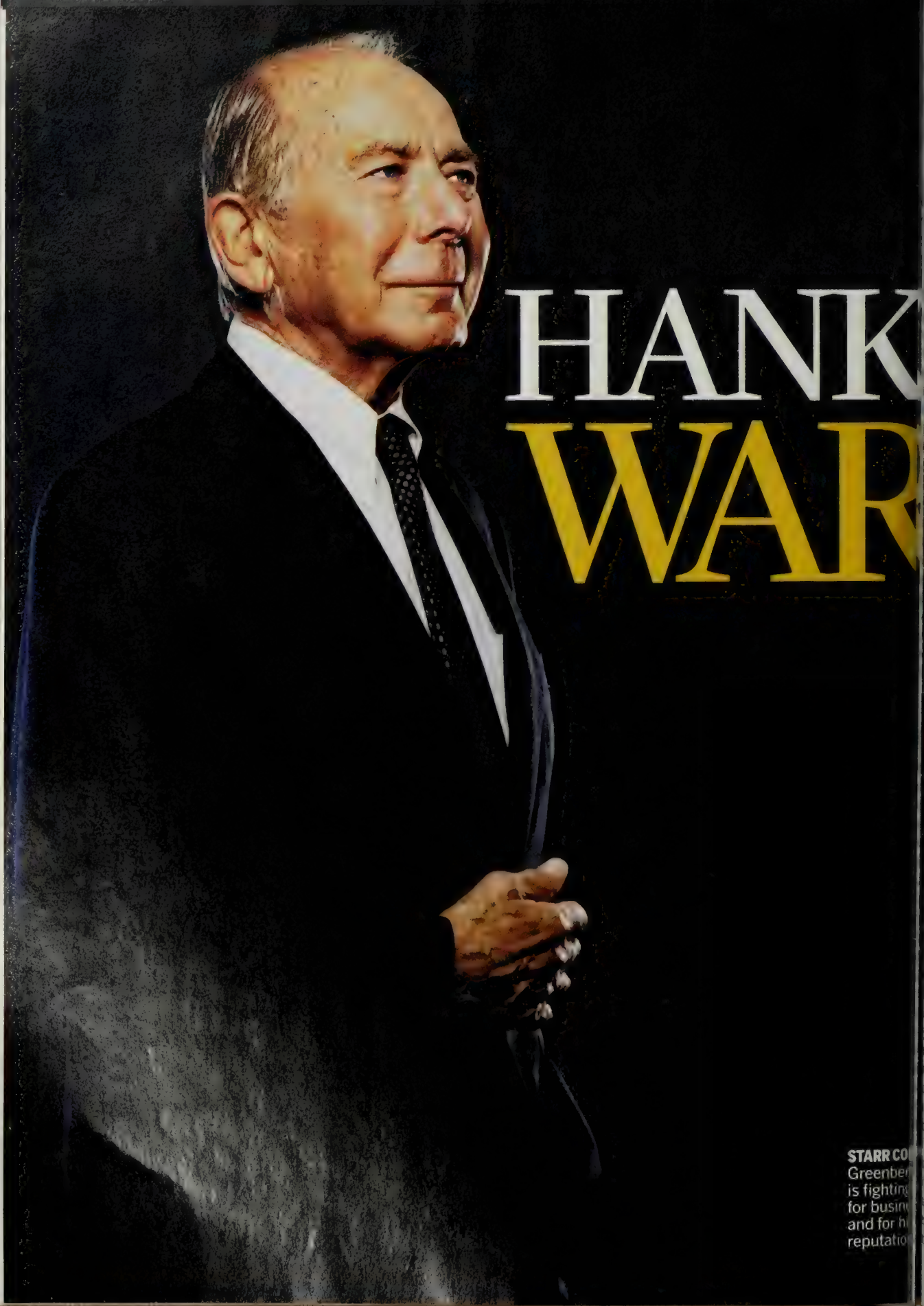


HANK WAR

STARR CO
Greenber
is fighting
for busin
and for h
reputatio

e year after Hank Greenberg was forced out of the insurance pire he built, the wounds are still raw. Then again, his battle inst AIG has only just begun BY DIANE BRADY

'S STRIKING ABOUT MAURICE R. "HANK" GREENBERG days is his determined air of playfulness. A man some- feared for his brusque manner, he greets me at the Park e office of C.V. Starr & Co., the private insurance compa- controls, by placing his hand gently on the small of my Having sat through interviews where the only refresh- were for him, this time I'm offered tea (albeit prepared y he likes it). The former American International Group airman asks about my travels. He teasingly taps me on n after chatting about the fun of starting over at 80 and ossing the planet to try to build a new multibillion-dollar ss through C.V. Starr and Starr International Co.—lu- private entities once affiliated with AIG. "I'm as busy as er been," he says. The events of the past year may have ated Hank, but it's hard to find evidence that they have ed him. As he says: "You don't tell the rank of a general size of his tent."

ed. The billionaire who once ruled the insurance indus- built AIG from a bit player to a $98 billion powerhouse this for fun. Mention the allegations of fraud that jetti- him from the command post he occupied for 38 years, eenberg's eyes turn icy. Four seasons have passed since forced out as chairman and chief executive, yet the s remain raw. His new business projects now seem less enture than an act of revenge. "I have to start all over he says angrily.

Leadership"

BERG IS AT WAR, AND HE'S crystal clear about who his are. One is the man who he believes went after him for reasons and smeared his reputation in the press: New orney General Eliot Spitzer, who declined to be inter- for this article. More important, Greenberg is targeting at's where he says he was betrayed, sacrificed out of ce, and stripped of honor. "It shouldn't have ended this says. He has amassed a high-powered circle of lawyers udes noted litigator David Boies and a public-relations l by Howard Opinsky, the former campaign press sec- r U.S. Senator John McCain (R-Ariz.). Greenberg will everything, whether it's more than $20 billion worth of customers at the agencies he took with him. He regards lready diminished, and he's not impressed with CEO Sullivan, especially since AIG announced a $1.6 billion nt with regulators last month.

an, the man Greenberg himself had positioned as a suc- ot only aided in demonizing him to appease Spitzer, proving to be a poor CEO, says Greenberg. "There's no ip there," he contends. "The place is run by outside he says, a charge AIG brushes off. Greenberg talks bious business decisions, a lack of fresh ideas, and a f fear in which old friends are told not to talk to him. cerned about the future growth of earnings," he says. r, he found AIG's legal campaign to block C.V. Starr king with other insurers to be "very distasteful." AIG even had his name taken off The Greenberg Suite at his beloved Portman Ritz-Carlton in Shanghai, which AIG partly owns. Would the man who directs about 16% of AIG stock through his personal holdings and Starr ever get out of AIG altogether? Not all at once, of course, but it's possible. "I'm going to wait and see," he says, with a thin smile. "Nothing stands forever."

Even some people who have known Greenberg for years claim to be stupefied by the rage just beneath the surface, incredulous that Greenberg won't let go. But he doesn't seem able to. He insists that he won't settle and that he did nothing wrong. He claims that he did too much, fought too hard, to have it end like this. Spitzer's high-profile civil suit and a Securities & Exchange Commission investigation are just the start of Greenberg's legal troubles. A more serious concern is the Justice Dept.'s ongoing criminal investigation focused on deals allegedly linked to Greenberg, although he has not been charged. Even the Starr Foundation, where Greenberg built his reputation as a philanthropist, is investigating Spitzer's claims that about 35 years ago its former chief helped to shortchange the charity of assets now worth $6 billion.

Hush-Hush

AIG'S STANCE IS TO ACT as if Greenberg simply doesn't matter. He's yesterday's man, a leader who hung around too long and operated too close to the edge; he's euphemistically known as one of "certain former members of senior management" in AIG documents. There's palpable frustration in some quarters that he won't just apologize, pay a fine, and go away. He's not welcome as a subject of open discussion. A call to one executive at AIG's Manhattan headquarters prompts an audible sense of unease. "I really can't talk about that guy in the office," comes the hushed response. With all the lawsuits swirling around, people are even reluctant to laud his past accomplishments. Sullivan offers up only guarded praise when pressed to comment on his old boss. "I learned a lot from Mr. Greenberg, but I learned a lot from other people here as well," says the pleasant-faced Briton. "I'm focused on moving forward."

As long as Greenberg continues to wage war, though, he can't. Greenberg won't give up a penny of the $21 billion in AIG shares he controls through Starr International (SICO), the private company that for decades had served as a compensation vehicle for AIG employees—and that he bragged was so critical to the company's success. "It differentiated AIG from all other companies and created a culture that was unique in Corporate America," Greenberg notes. AIG has sued for the bulk of those shares, arguing that they were committed solely to being used as future compensation for top AIG employees. But Greenberg no longer cares. He runs SICO and he's keeping it—and even some AIG executives quietly admit they're unlikely to get anything back. Greenberg will pay out what's legally owed, including Sullivan's pot, but that's it.

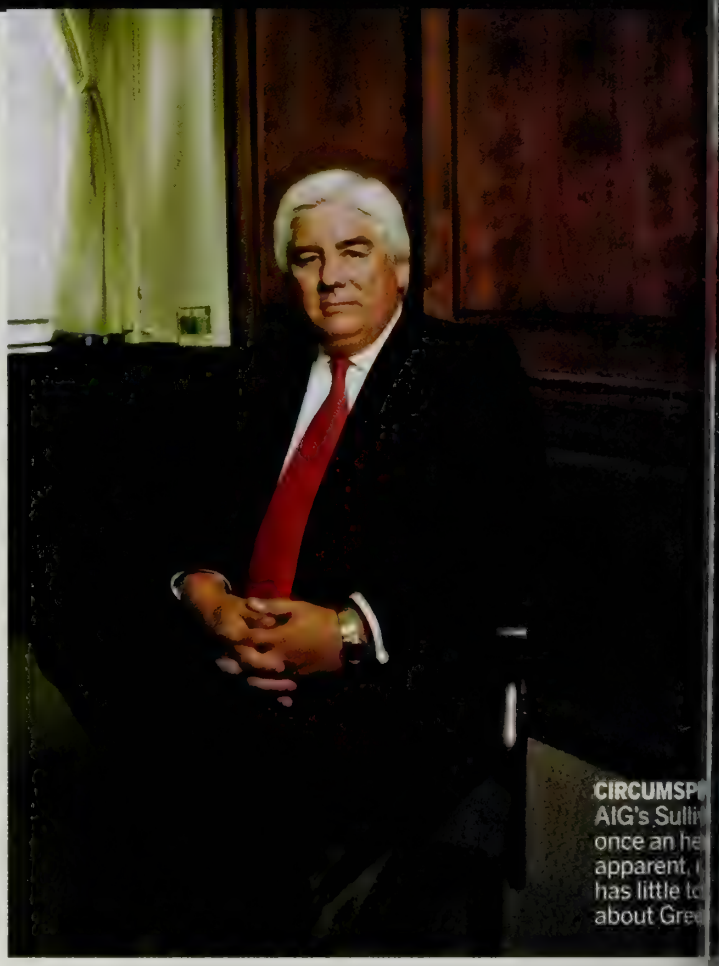
Then there's the drama over the fate of C.V. Starr, which is now competing with AIG for business. As a managing general agent, it was a middleman for about $2 billion in premiums on

policies underwritten solely by AIG. The agencies were often staffed with people who had similar roles and job titles inside AIG, leading some critics to call C.V. Starr a fictional intermediary snaring fees that should have flowed to the insurer. Greenberg dismisses those claims, noting that C.V. Starr provided the expertise and relationships with clients.

Greenberg has walked off with the bulk of that talent, taking back four specialized agencies: American International Marine Agency; American International Aviation Agency; Starr Tech, which focuses largely on the energy and chemical industries; and C.V. Starr, which handles excess casualty insurance in such areas as construction and trucking. He was willing to sell it all to AIG, but the offer was about $600 million short. On Mar. 15 he launched a national ad campaign to build a separate identity for the Starr agencies.

After the tense bidding came to an impasse, AIG severed all ties. Starr Tech began offering insurance on Feb. 28 underwritten by two AIG rivals, Berkshire Hathaway Inc. and Ace Ltd., whose CEO is Greenberg's son Evan. Berkshire, oddly enough, provided the backing for a suspect reinsurance policy through its Gen Re Corp. unit that first caught Spitzer's eye by allegedly boosting AIG's reserves by $500 million.

Until AIG's messy divorce from Greenberg, many customers weren't even aware that C.V. Starr was a private company. Many thought that they were essentially dealing with an arm of AIG. As one broker puts it: "That's who you were understood to be dealing with, and that was the paper backing you wanted." Some did know that it had morphed into an odd fraternity that awarded stakes to executives like Sullivan, who was bought out for an estimated $6 million last year. But no one anticipated a split.



CIRCUMSP
AIG's Sulli
once an he
apparent,
has little t
about Gre

Keeping Up Appearances

THE SUGGESTION THAT HIS companies can't thrive away from AIG makes Greenberg laugh. "That's wishful thinking," he says. The loser here, he says, is AIG, which provided only financial backing on deals structured by C.V. Starr. It was Starr that did the real work. If so, that's clearly an asset, says Patrick J. Gallagher, CEO of Arthur J. Gallagher & Co., the country's fourth-largest insurance broker. "If C.V. Starr still has the brain trust and the relationships, we will continue to access it for business." Moreover, says Greenberg, with its AAA rating, "Berkshire Hathaway is a better piece of paper these days."

Most brokers and risk managers are waiting to see what each company can offer. "Please don't ask me to get in the middle of Hank Greenberg and AIG," laughs one aviation industry risk manager. "They both scare me." Adds another risk man the energy sector: "I think of [Starr] as a startup, but it's up led by Hank Greenberg." Some clients, at least, happ ticipate a bloodbath. "The more capacity, the better," sa "I look forward to having both of them fight for my bus

The atmosphere at Greenberg's office on the 17th floo Citigroup building is indeed akin to a startup, except it's silver-haired men with billions of dollars' worth of AIG "We're starting all over again, only this time we're starti a lot of money," says Edward E. Matthews, Greenberg' time friend and president of C.V. Starr, which with SICO billion worth of projects lined up. Instead of the Chines uities and fine art now on display, the new space was i spartan, like "camping out," Matthews says, adding that berg "doesn't have to worry about managing 93,000 anymore." Matthews concedes their ambitions go only "At our age," he says, "we're not going to create anothe

Greenberg, though, is at pains to keep up appearan speaks at conferences, writes op-ed pieces for major n

Under Attack

The former AIG chief's battles are far from over

ELIOT SPITZER

The New York Attorney General's civil suit against Greenberg will likely not come up until 2007, after Spitzer is gone. At stake: potentially heavy fines.

JUSTICE DEPT.

Criminal investigation is starting to lead to indictments. If charged and convicted, Greenberg could face possible jail time.

SEC

Investigation could lead to fines and the prospect of being barred for life from serving in an executive role at a public company, if Greenberg is charged and found guilty.

AIG

Nasty fights over w controls billions in shares as well as w win the insurance business tradition handled by C.V. Sta

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rm reception all round

ing certain myths, the Japanese s community continues to be ing to outsiders: From real estate o employee recruiters and logistic ns services, everyone embraced ported our entry into new locations, our growth in an ever-improving e economy.

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In addition to a quality workforce at reasonable wages, for our business to succeed we need affordable real estate in good traffic locations. With real estate prices steadily decreasing since the all-time peak of the 90's, the Japanese business environment has sustained our continued growth.

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Robert Boxwell,
Managing Director,
Coffee Partners Ltd

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An Arty Niche—And Banner Sales

How a business was built on the banners that advertise museum shows

BY JOSEPH WEBER

WHEN NORA WEISER curated a Charles Rennie Mackintosh exhibition at the Art Institute of Chicago a few years ago, a colleague gave her a striking banner promoting the show that had hung from one of Chicago's streetlight poles. Soon, visitors to Weiser's home were asking where they could get similar banners from their favorite exhibitions. Surely, the sprawling 2.5-foot by 8-foot panels would dress up a living room wall or be ideal for a big foyer. The answer Weiser had to give: Sorry, but they just don't sell them.

Now they do, thanks to Weiser and her husband, Nicolas. Last year, they started selling vinyl banners from exhibits at 18 museums on their Web site, betterwall.com. The banners, which typically sell for $300 to $800 each, feature subjects from pre-Inca figures to geishas and Toulouse-Lautrecs. After flapping in the breeze in Chicago, San Francisco, New York, or elsewhere, the limited-edition banners have gone, scrubbed and ready for hanging, to hundreds of collectors since the Weisers started selling them in May 2005. "We have passionate customers," says Nicolas, 37, which enabled their business to bring in just over $100,000 in sales in their first 10 months.

BUSINESSWEEK SmallBiz

No one's more passionate about the business than the Weisers, who work out of their Denver home. Nora, 36, says she finds the self-employed life emotionally liberating. Not only does she have more time to spend with her two young children, but there's no need to seek approval from a boss, and her customers are a delight. "Each time a customer tells us something is wonderful, it feels s sonal and so good," she say

Betterwall.com brings to the diverse skills of Nicola Nora, who first met as undergr Washington University in St. Nora's art background inclu five-year stint at the Museum Assn., a trade group wher learned the complex cop rules governing images on ba Nicolas, a onetime environm consultant, learned about ent neurship when he ran Mucho Web-based market research that collapsed in 2002.

The Weisers and their thre ployees are well-attuned to customers' needs. Art lover nothing more than impressi unique pieces; one custon even redesigning part of her around her banners. And ums face the problem of disposing hardy vinyl material. Tossed in the the weatherproof banners could s landfill for 500 years, says Nora.

The Weisers first clear copyright Then they pay shipping fees for the ums to send the banners to their I facility to be cleaned and pressed. that can't be rehabilitated are recycl floor tiles or other vinyl products. Th Weisers kick back a portion of each the museums. While the museums get rich off that money, "We're th says Shannon P. Dean, marketing m er for the San Francisco Museum o ern Art, adding she wouldn't mind o a few banners herself.

The Weisers have found instit keen to work with them. Along wit York's MoMA and the Art Instit Chicago are regional operations s the Toledo Museum of Art. With t Gallery of Ontario on their list, the to add more from abroad.

Still, the business can be tricky. tors try to reserve banners, but the W never know how many they'll wi with. Rough weather or too much s make banners unsalab names of corporate sp may have to be stean the banners if they agreed to the resale.

For now, the business is tiny. rently carries about 75 different d among the 1,000 banners in stock. a big joy for the Weisers. "I may no a million, but I can have the life want and really enjoy what I'm d Nora says. And plenty of collecto enjoy the fruits of her labor, too. ■

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A Body Blow To Illegal Labor?

Court rulings and legislation could change the game for companies such as Mohawk

BY BRIAN GROW

IT COULD SOON BE HIGH NOON in Calhoun. The town of 13,000 tucked away in the northwest corner of Georgia has been reshaped during the past decade by a huge influx of Latinos. The big draw: jobs at Mohawk Industries Inc., the town's largest employer. The $6.6 billion carpet maker employs 32,000 workers in all, 4,000 of them in Calhoun and surrounding Gordon County. Once staffed largely by whites, Mohawk today has a workforce made up substantially of immigrants from Mexico and other Latin American countries. The lure of $7-an-hour work has helped lift Hispanics to 12% of Gordon's population today, up from less than 1% in 1990.

Increasingly, some Anglos, as many locals call themselves, are feeling threatened by the newcomers. Drive past Calhoun's quaint downtown courthouse, and you'll see new Latino-owned shops and restaurants, such as La Hacienda and La Tienda Guadalupana, lining the streets. Spanish is so prevalent that Taxi Domingo feels compelled to reassure white customers by putting advertisements on its cabs that say: "We speak English!" Says Gary White, a deacon of the local Agape Baptist Church: "The numbers [of immigrants] and the language are a problem." On Mar. 12 his church hosted Race Relations Day as part of an ongoing dialogue on the clash of cultures.

Now Calhoun finds itself in the middle of the nation's heated debate over illegal immigration. Two years ago tensions between immigrant and local workers at Mohawk Industries spilled into the courts in a case that could affect all companies employing some of the estimated 7 million illegal aliens working in the U.S. Four current and former Mohawk workers brought a class action against the company for allegedly conspiring to depress their wages by hiring illegal immigrants. Filed in federal court, the suit alleges that Mohawk, sometimes with help from local hiring agencies, knowingly accepted false documents, recruited illegals at the U.S.-Mexico border, and rehired undocumented workers under different names. "To the managers of Mohawk, the influx of illegals is a dream," charges Bobby Lee Cook, a local lawyer representing the workers. "To others, it might be the apocalypse."

In its legal briefs, Mohawk denies all the allegations. But the suit poses a threat to U.S. business because it was filed under the Racketeer Influenced & Corrupt Organizations Act (RICO), a 197 passed to fight the Mafia that a triple damages against those foun in violation. Congress amende statute in 1996 to allow workers corporations that knowingly hire workers. Three similar lawsuits are ing their way through the federal

In Mohawk's case, two lower co fused to dismiss the plaintiffs' com and now the U.S. Supreme Court p

(CLOCKWISE FROM TOP) MICHAEL A. SCHWARZ; ANN STATES (3)

Hiring Immigrants Is Getting Riskier

THE STATES

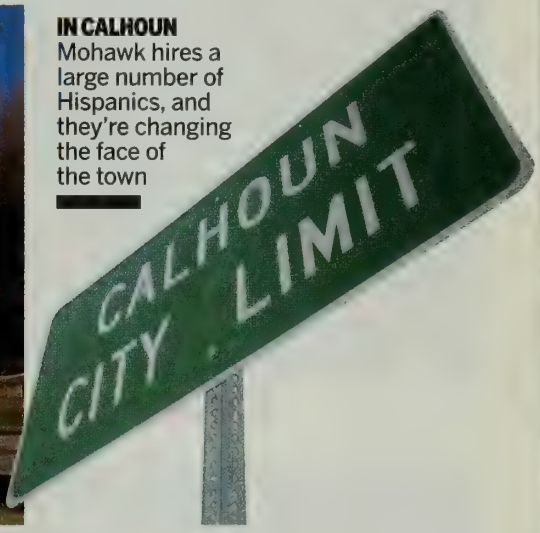
Several have bills pending to use tough tactics against hiring illegals. Georgia's, for example, would limit businesses to deducting no more than $600 a year from their state taxes for wages paid to illegals.

THE COURTS

A case coming up in April before the U.S. Supreme Court looks at whether employers can be held liable under racketeering law for hiring illegals to allegedly drive down the wages of U.S. workers.

WASHINGTON

The House GOP pass make it mandatory fo employers to check j legal status on a fede site, a program Presi funds in his new bud



IN CALHOUN
Mohawk hires a large number of Hispanics, and they're changing the face of the town

Business groups acknowledge that some kind of crackdown is inevitable. For years, lax federal and state enforcement of existing laws has given employers virtual carte blanche to hire illegals. Just four notices of intent to fine employers of unauthorized workers were issued in 2004, down from 417 in 1999, according to the Government Accountability Office. If that now changes, the result would be a catch-22 for employers that want to stay in the U.S. but have grown dependent on cheap, illegal labor as a way to remain globally competitive. A Mar. 8 report from the Pew Hispanic Center estimates that undocumented immigrants account for 24% of the country's agricultural workers, 14% of construction jobs, and 9% of manufacturing occupations.

That's why the toll of immigration reform could potentially be seismic for

hawk's appeal on Apr. 26. The rt won't consider the underlying ns. Instead, it will decide RICO could apply to companies tuation.

court rejects Mohawk's defense, ies would essentially be convert- aw enforcement agencies," says orillo, a Mohawk attorney at Si- in LLP. Mohawk declined to dis- case but issued a statement Morillo, arguing that the plain- t to force employers to limit or ing Spanish-speaking employ- hawk intends to stand firm in its e to these extortionate litigation ays the statement.

SH RACTION

HAWK SUIT is coming to a head es to combat illegal immigra- a crescendo in the courts, Congress, and state legislatures (table). Many of these efforts would get tough on employers that hire illegals. Plaintiffs' lawyers are pursuing other RICO-based suits, including one filed in 2003 against Wal-Mart Stores Inc., and such initiatives would get a boost if Mohawk loses in the Supreme Court. Meanwhile, Congress is embroiled in an acrimonious debate about bills requiring employers to validate workers' Social Security numbers, as well as demands by Senator John McCain (R.-Ariz.) and others to extend some kind of legality to the nation's illegal workforce (table, page 88). State legislatures are considering their own laws. "We are close to passing an enforcement-only regime that seeks to solve the illegal immigration problem largely on the backs of employers," says John Gay, senior vice-president for government relations at the National Restaurant Assn.

Calhoun and Mohawk. The town has an unemployment rate of 4.3%, below the national average of 4.8%, so the hunt for able-bodied workers is already intense, say local officials. At Mohawk, a large majority of the workforce in its 26 Georgia plants is illegal, alleges the lawsuit, which was brought by Howard W. Foster, an attorney at Johnson & Bell Ltd. in Chicago who pioneered the use of the RICO Act to sue companies alleged to hire undocumented workers. Mohawk attorney Morillo says that the company's Latino workforce is "large" but says the company doesn't probe the validity of Social Security numbers and other worker documents. Says pastor Stephen H. "Esteban" Edwards, coordinator of ethnic ministries of the Gordon County and Memorial Baptist Assns.: "If there were a housecleaning of Hispanic immigrants, [Calhoun] would

collapse." Most of his members are Hispanic, some illegally in the U.S., he says.

Despite Mohawk's denials, the lawsuit alleges that the company hires many of its workers through local temporary help agencies. The $7 starting wage is a sore point for some locals and white Mohawk workers, who say Latinos' willingness to accept low pay depresses overall pay rates. "If a lot of them weren't here, our wages would be higher," says a 10-year veteran at Mohawk who earns $15.65 an hour in the maintenance group. Mohawk says in its statement that it pays competitive wages.

Mohawk's starting wage of $7 is a sore point for locals

Plaintiffs' attorneys allege that Mohawk goes to great lengths to hide illegal immigrants on its payroll. In 2004, according to the complaint, the company fired three illegal workers. But two months later, "Mohawk rehired these same employees under different names to work on different shifts in the same facility," the complaint alleges. During government raids, say the plaintiffs, some illegals hid in barrels or ran from factories. Mohawk denies the allegations.

Federal legislation requiring Mohawk and other U.S. employers to scrutinize the Social Security numbers and immigration status of all workers could add to companies' hiring woes. A voluntary program operated by the U.S. Citizenship & Immigration Services (USCIS) known as the Basic Pilot, has garnered little support from business. Only 2,900 of the nation's estimated 7 million employers participate in the program. And the government is ill-prepared to handle more. Of 73,000 employee checks referred to USCIS last year, a third required case officers to investigate further because the agency lacked sufficient data about employees' status.

Companies that have volunteered for the pilot say the reporting mechanisms are flawed. Giant chicken processor Tyson Foods Inc., which joined in 1998, says the program helps verify Social Security numbers, but it cannot identify immigrants who may have assumed other people's names and personal data. "We believe companies should not be placed in the role of policing who has proper work documentation," Tyson spokesman Gary Mickelsor statement. Tyson was able to def RICO suit brought by the Justice similar to the one Mohawk is fight

McCAIN

"TWO-FRONT BATTLE"

EVEN AS THEY await a ruling or hawk's case, some in Calhoun are gr worried that an immigration crack through the courts or Congress, coul a lasting effect on the town. With a of workers in the region, Hispani crucial if the city's No. 1 employer is to keep production from moving where. Calhoun Mayor Jimmy H boasts that Mohawk retained or adde jobs in Gordon County last year, in p cause it could find new employees. fect of a crackdown "would be ver significant and very, very costly," sa Lance, a Calhoun nati former head of the O Management & Budg der former President Carter. "It would be front battle: checki current workers and ing [those] who leave

The debate is ri through state capita Legislators from Geo Arizona are facing of split between business supporte those eager to tamp down illegal l bill expected to pass soon in the legislature would require that a nesses check Social Security numb status. Businesses found to hire would be limited to deducting fro income-tax filings no more than year for wages paid. Tough polici gained momentum as officials with the more than 200,000 illega grants now living across the state. is sponsored by Republican state and former talk radio host Chip who took up the issue after years ing his phone lines light up wher legal immigration was raised.

On Richardson Road in Calho than a mile from a major Mohav complex, an array of storefronts scores the town's demographi There's La Sorpresa Tienda M selling BEST Mexico brand phone cards. La Clínica Santa fers medical services to Spanish ers, and El Arroyo Mexican se tacos and tequila. But Bubba Shop has closed its doors. In th debate over immigration refor in Calhoun are hoping Mohawk end up like Bubba's. ■

Fixing Immigration: **Everyone** Has a Plan

Congress is wrestling with a slew of bills that would step up border enforcement and set new rules for undocumented workers. Some bills dealing with the 12 million or so illegals now living in the U.S.:

AUTHOR	PROPOSAL
SENATORS JOHN McCAIN (R-ARIZ.) AND EDWARD KENNEDY (D-MASS.)	Illegals now in the U.S. can get temporary work permit for six years, then apply for permanent residency after paying $2,000 and learning English.
SENATOR CHUCK HAGEL (R-NEB.)	Those who have been in the U.S. for five years can get work permits and eventually permanent residency. Others get three-year permits but then must leave the U.S.
SENATOR ARLEN SPECTER (R-PA.)	Illegals here two years or more can get open-ended work permits but can't become permanent residents. They must leave the U.S. if they're unemployed for more than 45 days.
PRESIDENT BUSH	New guest-worker program would allow illegals to work for three or possibly six years. He hasn't said if they then could apply for residency or would have to leave the U.S.
SENATORS JOHN CORNYN (R-TEX.) AND JON KYL (R-ARIZ.)	Illegals in the U.S. now can get temporary work permits but only if they go home to apply and then reenter the U.S. They must leave the U.S. permanently after five years.

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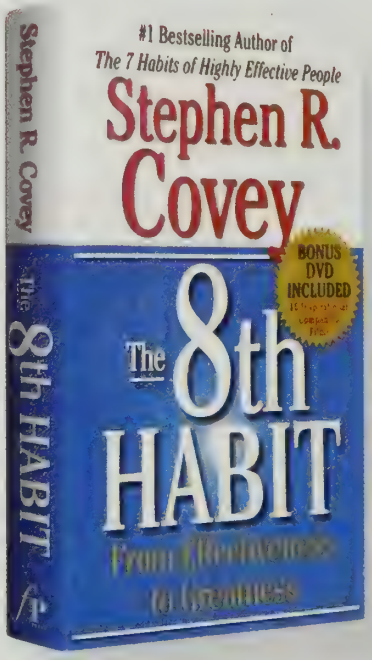

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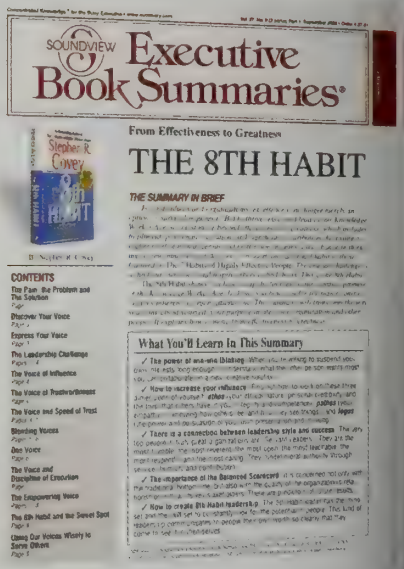

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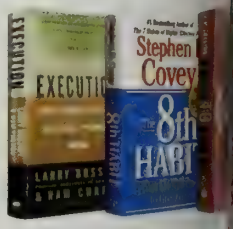

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The Winning Business

Lee Dittmar
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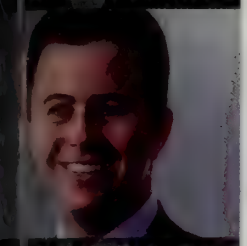

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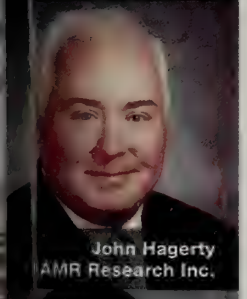

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Sarbanes-Oxley

Smart Companies Are Figuring Out How to Find the Silver Lining

Complying with the Sarbanes-Oxley Act of 2002, though still a significant challenge is also a way to effect much-needed change throughout your company. Our group of SOX players gathered to note the trials and tribulations of compliance efforts. Their consensus, excerpted here, may surprise you.

How have the realities of SOX compliance matched expectations?

Lee Dittmar: As year one ended, we expected companies to undertake improvements to make compliance easier, make their controls better, and address the efficiency and effectiveness opportunities. Instead, we observed almost a slowing-down of activity after the first attestations cycle. People had worked very hard, literally for years, to comply with Section 404 of Sarbanes-Oxley, and there clearly was a lot of fatigue. Over time, though, people started to realize that, "If we keep doing what we're doing, we'll keep getting what we're getting." As a result, we've seen an increase in the amount of effort around the improvement of controls, streamlining of compliance programs, and a significant focus on the scope of the 404 assertion and attestation.

How are companies moving from theory to a more practical application?

Stephen Masterson: In year one, everyone was trying to understand what the Sarbanes rules were. The Securities and Exchange Commission hadn't given a lot of guidance, and there was a lot of interpretation from the auditing firms. But the industry erred on the side of "more is better." Over the last year or two, management has begun asking, "What are the laser-focused risks for financial reporting?" And today companies are automating the control environment, because a manual control environment is never going to be efficient in this new world of internal control reporting.

Sun Microsystems has had a lengthy journey toward compliance.

Ira Bloom: Because of our June 30 fiscal year end, we were expecting to be in the first wave of compliers, so we had to get up and running very quickly. It was immediately communicated by senior management that this was our number one priority. Right away we realized that our process documentation was of inconsistent quality, so we hired a Big Four firm to help document our processes, while mobilizing our finance and IT organizations to participate in both documentation and testing of controls. Then, in February of '04, the implementation date was postponed. Although we continued to remediate and test the most important controls, we focused on designing the next fiscal year's program. We concentrated on making the compliance process itself more manageable and predictable. It wasn't until planning for our current fiscal year that we could focus on reducing the number of key controls, and so our workload in year one was still enormous for everybody.

For a podcast of the complete roundtable: http://www.deloitte.com/us/consulting

Do companies need to rationalize these controls?

Dittmar: Yes, companies have to take a hard look at the opportunities to make their controls more efficient and more effective. This is traditional re-engineering work – good old process re-engineering. Companies now need to look at their controls through a risk-based lens: what really matters, what are the risks, what are the things that could go wrong, and what's the most efficient and effective way to address the risk? That takes work, expertise, time, and effort. But in the end it can and will reduce costs, increase the effectiveness of the controls, and improve the quality of the financial information produced by the organization.

How is technology supporting compliance efforts?

Renee Lorton: After the scramble that customers went through to achieve their Section 404 goals, they have a mountain of data about business controls to sort through and make sense of. So we're seeing our customers use business intelligence capabilities like planning, reporting, analysis, or scorecarding on top of this data to get their arms around this immediate challenge. Customers need the ability to sort through the complexity of this multidimensional challenge in order to intelligently reduce the number of controls, to find out where they're over-controlling and testing too many controls, and where they have possibilities of re-engineering their processes for compliance efficiency and productivity.

What is the state of the market for tools?

Masterson: We're entering an era where some software tools that manage, track, and test the controls and automate the internal reporting of control results are starting to be very good. In year one, not all of the tools were as good as they are today. Over the last two years, software companies have spent a lot of time refining and enhancing the tools and fixing problems. Now the tools are becoming much better.

It's not just large companies involved in Sarbanes-Oxley compliance.

John Hagerty: No, the next wave of companies who will be addressing this for their first year will be foreign registrants – companies based outside the U.S. that trade stock or issue debt here. Then we still have small-cap companies, those firms that are $75 million or less in market cap, whose deadline has been pushed out further and further. I know there's a lot of conversation right now to figure out what this might mean to small companies.

Gerry McGrath: There are smaller companies that will not pursue 404 compliance efforts. They will seek to go private or go dark – in other words, remove the SEC reporting obligation and, accordingly, the obligation to have to comply with Section 404. They admit in their SEC filings that the cost of compliance is too great. Also, some accelerated foreign private issuers are running into the 404 obligations for fiscal yea July of this year. They are looking hard at whether they c actions to remove themselves from SEC reporting obliga

How much will companies spend on compliance going forward?

Hagerty: What we heard is that, by 2007, about $28 b is going to be spent on compliance overall. What that br to the forefront is that compliance is everywhere in an org tion – the way you make products, the way you deliver pro what you tell people or can't tell people, privacy issues, anc It's everywhere.

What business benefits are companies gaining from SOX compliance?

Hagerty: Streamlining of business processes on both business and IT sides has been the key benefit of compli far. But they're also getting better quality – both better-q products as well as better quality of information; a more environment; better visibility into operations. Compliano becoming the lever that will force other change in the bu

Has Sun also experienced significant benefi

Bloom: Yes, our teams are executing their processes a performing controls better. We're seeing fewer deficienc our testing this year than we saw year one. In general, pe are getting smarter about process and internal control de with control considerations being addressed much earlie in the past. Additionally, a lot of work is taking place to a long-standing process inefficiencies that were previously considered high priorities.

Ed Glover: From an IT side, one of the benefits of our SOX efforts resulted in identifying some of the hidden iss left over from our evolving organizational structure and le processes. It became very apparent why certain processes of documented processes were causing failures. We were streamline our processes and organization, which resulte IT organization becoming more efficient and effective in oping and implementing solid processes with strong cont built in. Another benefit of our SOX efforts was to unders how SOX fits into our new initiatives and projects. The IT team is now being asked to participate in our major busi IT initiatives to make sure that controls are being built i architecture, instead of bolted on later. I'm seeing a much cooperation among the groups within the IT and busines nizations. This will result in improving our business/IT p and internal control framework within both organizatio

Are there benefits from creating a better partnership between CFOs and IT?

Lorton: Yes, there is a direct association between the goal of achieving compliance excellence and the CIO

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of automating and making the organization more efficient. CFOs need to reach beyond the walls of finance to other functions in the organization. If you're in a large organization, you can't just do that by relationship. You have to depend on systems infrastructure to pull functions together to support cross-functional processes like budgeting and planning, performance measurement, and management of the organization.

So there can be a performance dividend?

Lorton: Yes, absolutely. We have one customer that unearthed the fact that they have 42 different ways of achieving the same process globally in their organization. Think about the efficiencies they'll achieve now by narrowing this down to one common process. So much of the challenge of Sarbanes-Oxley is ending in a performance dividend, with very good results for organizations and business in general.

How great is the need for change management?

Masterson: We need a process so that each month, each quarter, if we change significant key controls in the business units or in the processes, those changes are elevated through a reporting mechanism. That way, in the assessment of internal controls and the certifications that CFOs and CEOs make quarterly and annually, they know what those changes are. We need a similar change control process or a notification process of change for internal controls over financial reporting similar to what we do in the IT world.

Anything new that executives should conside

McGrath: One important development should keep p focused on the importance of this issue. The SEC recentl announced it has settled an enforcement proceeding aga public company for violating requirements relating to int controls over financial reporting. The company admitte that it violated the internal control over financial report requirements due to, among other things, failure to mair appropriate accounting practices. The announcement shows the SEC is very focused on this issue, and, hopeful encourages companies to continue compliance efforts.

What is AMR's best advice going forwarc

Hagerty: Use technology judiciously. Use it to autom those activities that will become more mundane, but als balance the investment to improve your business and m compliance requirements. If you can streamline activiti terms of business systems and/or business processes, th great benefit of compliance.

The benefits are clearly significant.

Dittmar: Absolutely. Compliance forces you to look at y data, your processes, and your systems related to the turn data into financial information. Good controls and high-l information are good business. This is a way to turn the f away from mere compliance costs and to really leverage th pliance efforts — to improve the value of the business and performance of the business and to increase overall enter

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Beyond The Annual Physical

Well-heeled worriers are signing up for wide-ranging tests. We try a pricey new one. **BY CATHERINE ARNST**

HOW MUCH DO YOU REALLY want to know about your health? For most of us, the annual physical—a little blood work, a little poking and probing—will more than suffice. But for the well-heeled worrier, there are far more detailed and costly options: one- to two-day executive physicals that cost thousands of dollars, $500-and-up full body scans, and now, a $3,400 blood test named the Biophysical250 that screens for 250 possible diseases, at least 150 more than most standard physicals.

"Very American," my own admittedly skeptical doctor sighed when I told him I'd tried the latter option for this story. Then came the warning: "The problem with checking so many things is that you can end up spending a lot of unnecessary time and money chasing after abnormal lab results that are most likely meaningless." True, of course. And the test certainly flies in the face of current medical thinking, which holds that the commonplace annual physical is largely useless. Standard tests rarely uncover disease and have not been proven to prolong life. Yet a recent survey of primary care doctors found that 78% of their patients still expect a routine physical.

Some people want far more, and that's where Biophysical250 comes in. Available since last fall only from Biophysical Corp. of Austin, Tex., it is just one example of the quest for what could be seen as too much information. The company sends a nurse to your home to draw two tablespoons of blood, then the samples get shipped to Austin to test for everything from the mundane—cholesterol and blood sugar levels, infection—to the downright scary, such as dozens of proteins and enzymes that could indicate the presence of cancers, autoimmune diseases, or weird genetic anomalies. The test screens for 39 markers for heart disease alone. It does not, however, screen for diseases about which nothing can be done—Alzheimer's and Parkinson's, for example. And most insurers do not cover i

Biophysical250 is based on the most diseases are caused by a nu factors gone awry in the blood. B cal figures it is far more likely to potential problem by combining sults for a multitude of related markers rather than assaying jus

That sounds pretty scary if y give much thought to all the thi could go wrong with your body could describe my "What, me approach. I hadn't had a phy over four years when a Bio nurse arrived to draw my blo weeks later, an impressively binder of my results arrived in o delivery. I scanned the many many numbers with some tre but an hour-long phone cons with a Biophysical physician, Dr Rodgers (part of the service), pu my fears to rest. I have no sign cer, thyroid disease, diphtheri bolic syndrome, or lupus. I do h LDL cholesterol, a surprise giver readings had been normal in but my own doctor wants to r before taking any action.

FALSE ALARM

I ALSO HAVE SOMETHING new about: a slight deficiency of alph trypsin (AAT), a blood protein tects the liver and lungs. The tes was developed only a decade ago sparsely administered. A serious cy, which is rare, can lead to em and cirrhosis of the liver, two de eases. My level was only slight and since I've never smoked an an alcoholic, Dr. Rodgers told n nothing to worry about. Good though, if I'm tempted to take u haviors down the road.

On the other hand, I could pro safely through life without bei for AAT. All in all, Biophysical25 affirmation if you're fairly certa in good health, and an early war tem if you're not. Robert Crandal CEO of American Airlines, was o first to try it in a test run a year says it confirmed what he alread he's in great shape. "It's a great tic tool," he says. Still, he has no take it again. Why not? "Beca want $3,400 for it. Until the community says you need this f of tests, I see no need to repeat i

Crandall, and many other to

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102 New ETFs to cover every investing angle
104 Seven smart growth-stock picks
108 Plus: Spa condos for sale

In e Blood

ysical Corp. runs 250 tests h client's blood, for a fee of 0. Here's a sampling of the es they might uncover:

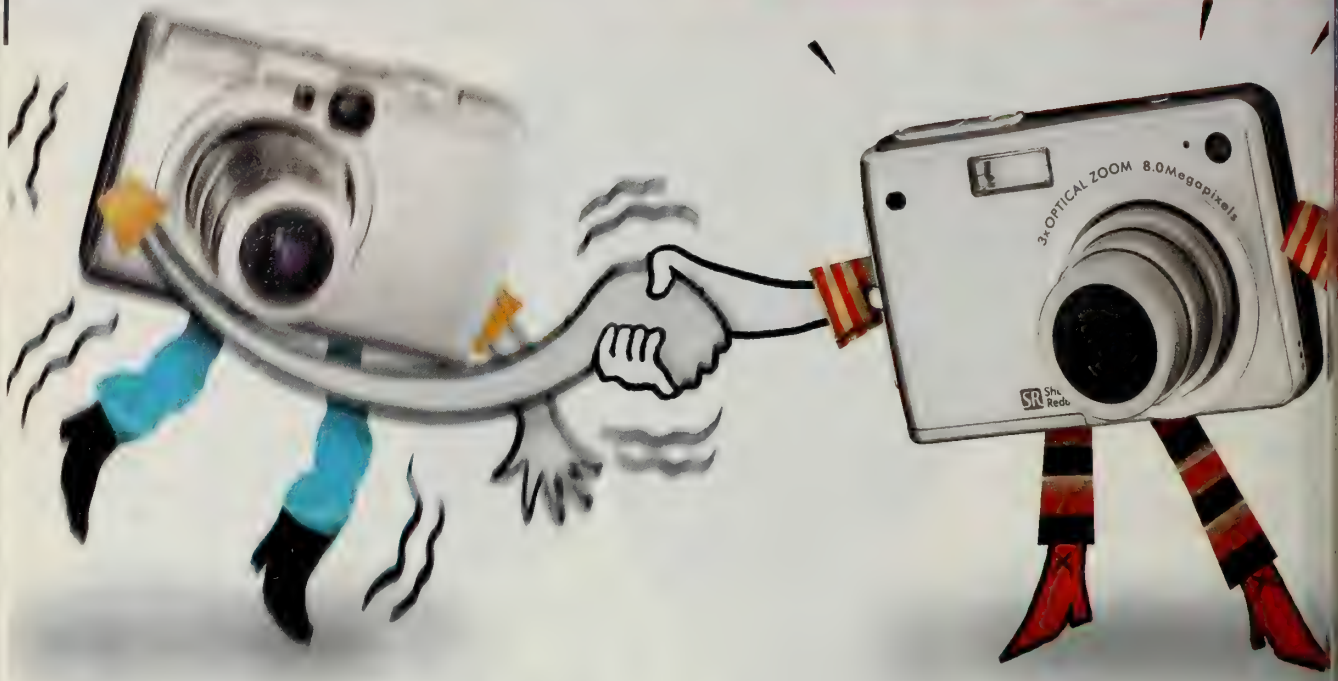
tives, are more than willing to repeat an executive physical, the gold standard of checkups. At institutions ranging from the Mayo Clinic and Johns Hopkins University to a Canyon Ranch spa or other luxury resort, people who have plenty of money, or who work for companies willing to spend it on their behalf, can go though extremely comprehensive exams and lengthy doctor consultations to ferret out any disease or lifestyle problems. Most of these programs take two days and cost $2,000 to $8,000, depending on the tests ordered up and the luxuriousness of the surroundings.

LISTENING FOR CLUES

AT THE MAYO CLINIC in Rochester, Minn., one of the first to offer executive physicals, the hallmark of the two-day exam is a lengthy initial meeting with a doctor. "We do run the standard evidence-based tests, but we also listen very carefully to the patient and pursue any clues they may give," says Dr. Deborah J. Rhodes, director of Mayo's program. She gives the example of a 37-year-old man who mentioned in passing that he recently noticed one testicle seemed smaller. This common asymmetry would have barely been noted, except that the patient said it was a recent change. As a result, Rhodes ordered a test for testicular cancer and discovered that the man had the very earliest stages of the disease, catching it long before it would have been found in a physical exam.

The patient might have detected the same cancer had he undergone another option for people who want to know every last thing about themselves, the total body scan. In this test, you are rolled into a computer tomography (CT) scanner, a sort of high-def X-ray, and it records every potential tumor in the body. The full body scan is held in low esteem by the medical establishment, however, because most of the clumps it turns up aren't tumors. Or if they are, they will never advance to a cancerous stage. In one study of smokers whose lungs were screened with a CT scanner, 74% had potential tumors, but only 4% turned out to have cancer.

I'll skip CT scanning. But while my doctor was checking out my Biophysical results, he scheduled me for a mammogram, colonoscopy, and bone density scan. I've officially joined the ranks of the health worriers. ■



Getting Rid Of the Shakes

The latest digital point-and-shoots offer a high-tech solution to blurry photos. BY LARRY ARMSTRONG

YOU KNEW IT WOULD make a great snapshot the instant you saw it. Unfortunately, your camera didn't. The resulting photo was blurry. And the moment—a child blowing out the birthday candles, a dog catching a Frisbee, a waterfall shot from the car—has passed.

Chances are your camera, and your photo, was the victim of your own hand. It's tough to hold a camera steady enough to get a flawless shot, especially one of those slim and stylish ultracompacts. That's especially true if you're shooting under less-than-perfect conditions. Indoors, say, or outdoors at dusk. At night, in the shade, or on cloudy days. In a church or museum where you can't use a flash. From an awkward position or a moving vehicle. For extreme close-up or telephoto shots. Get the picture?

In fact, the biggest complaint that amateur shutterbugs have about digital point-and-shoot cameras is fuzzy photos, and camera makers are starting to listen. Now, virtually every major company has or shortly will have at least one compact outfitted with what's generically called image stabilization, a feature that somehow reduces blur. I collected models from eight manufacturers (Kodak and Hewlett-Packard are absent from this part of the market) to see how—and how well—they did it. The cameras all had resolutions of 5 to 8 megapixels and a 3x to 4x zoom lens. Prices ranged from about $300 to $500.

I found that most of these cameras made for a noticeable difference in the sharpness and quality of the picture under different shooting conditions. I now think image stabilization is the new must-have for compact cameras—more so than big screens or resolutions of more than 4 or 5 megapixels, decisions make after you narrow your ch stabilized models. That's especia for the casual shooter, someon more interested in 4x6 snapshots of 16x20 framed portraits, someo wants to grab a lot of shots on the have them all look good.

Image stabilization is the new must-have feature for compacts

To understand how these work, you need to know what cau snapshots to be blurry. It might you don't know how to use the au feature: Usually, you should be sq the shutter down halfway to eng focus and then all the way down the picture. You should make s the camera is focusing on the usually the object in the center of ture (although Nikon cameras find a human face anywhere in t and focus on that).

More often, though, it's beca can't hold the camera still while t ter stays open long enough to picture. As cameras have become and more convenient, they've come harder to steady. Their sma collect less light tha cameras, which mea shutters have to rema longer. Most comp longer have an viewfinder, either: Y bracing the camera your face but holdin your arms—or wors extended to frame ture, exaggerating t ing effect. (Of this ba the Nikon Coolpix P4

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Canon PowerShot SD700 IS have a viewfinder.) Experts will tell you to use a tripod, but that defeats the purpose of a tiny camera, doesn't it?

You can combat the shakes two ways. Traditionally, makers of cameras with long telephoto lenses, where even the tiniest movement will blur the picture, have used a mechanical optical image stabilization system. A gyroscopic sensor in the lens or camera detects any horizontal or vertical movement and corrects it by signaling tiny motors to adjust a floating element in the lens. Such cameras as the Canon and Nikon, Sony's Cyber-shot DSC-T9, and all Panasonic Lumix cameras use the same technique. The Optio A10 from Pentax uses a variation: The motors move the image sensor instead of the lens to compensate for any camera movement.

One way to freeze the motion: More sensitive sensors

The other way is to increase the sensitivity of the sensor: It will collect light faster so that the shutter doesn't stay open as long, essentially freezing the motion before any shaking is registered as a blur. That's how the Stylus 710 from Olympus, Fujifilm's FinePix V10, and, to a lesser and less effective degree, Casio's Exilim EX-S600 do it. The advantage is that the increased sensitivity, indicated (as with film) by a higher ISO rating, stops the action of not only a shaky camera but also of the subject, such as a fast-moving child or pet. Mechanically stabilized models can't do that. The disadvantage is that images shot at higher ISOs traditionally have looked grainier—it's called noise on digital cameras and also shows up as color speckles—than those shot at slower speeds. I printed out some prints from these cameras, though, and that kind of noise wasn't much of a problem.

Most of the cameras make it easy to find and use the stabilization feature. The Nikon, Panasonic, Pentax, and Sony models have a button on top so you can turn the feature on or off without hunting through menus; on the Olympus setting on the dial. In any case, I mend turning it on and leaving it though on cameras where it's mented mechanically, that will dr battery a little faster).

For their slim size and stylisl looks, I liked the Casio, Olympu Sony models. If you want a big sc show off your pictures to friend film's FinePix is, at three inch biggest. If you want an optical viev useful for very dark or very bright tions where it's difficult to see the pick the cameras from Canon or Besides, those two will let you stea camera the old-fashioned way—b ing it, with both hands, up to your

BusinessWeek weekend

To see Larry Armstrong demonstrate how these cameras work, watch our weekly TV show, *BusinessWeek Weekend* (check local l or view it at businessweekweekend.cc

For more details about individual models and a slideshow, go to www.businessweek.com/extras

Going Steady

No more fuzzy photos when you use the image stabilization feature that is built into these digital ultracompacts

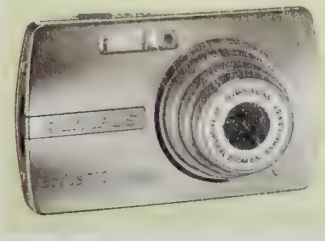
CANON PowerShot SD700 IS
6 Megapixels $500*
Coming in April, Canon's newest ELPH camera is one of the few compacts with a viewfinder

CASIO Exilim Card EX-S600
6 Megapixels $283-$370
The slimmest of the point-and-shoots, it also comes in silver, orange, or blue

FUJIFILM FinePix V10
5 Megapixels $280-$360
This FinePix model fights blur with an ultrasensitive imager and also has a giant 3" screen

NIKON Coolpix P4
8 Megapixels $400*
Due in April, this powerful c has full manual controls a find and focus on a human

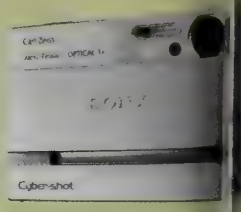
OLYMPUS Stylus 710
7 Megapixels $286-$350
The weatherproof Stylus 710 doubles the range of the flash when it's in the stabilization mode



PANASONIC Lumix DMC-FX01
6 Megapixels $350
The compact FX01 has a wide-angle 3.6X zoom lens that's good for landscapes or group shots in small rooms

PENTAX Optio A10
8 Megapixels $320-$350
The new flagship from Pentax is one of the few that can record video clips in the high-quality DivX format

SONY Cyber-shot DSC-T
6 Megapixels $344-$45
This stylish Sony model is first camera to use optical zation in a zoom lens that extend from the camera's



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Funds to Cover Every Angle

A host of new ETFs offer opportunities in diverse niches. **BY AARON PRESSMAN**

JUST A FEW YEARS AGO, exchange-traded funds were primarily a low-cost way to invest in broad stock and bond market indexes. Not anymore. Today fund managers are rolling out a diverse array of new products, hitting niches, such as commodities and currencies, or stock market sectors that the major indexes miss. Investment strategists and financial advisers say the right dose of these specialized ETFs can improve portfolio performance.

The most straightforward way to use the new funds is to diversify a portfolio of stocks and bonds. The key is to find investments that don't move in sync with what's already in the portfolio—or better yet, zig when the other parts zag.

Sure, a few conventional mutual funds can do the job. But they often have higher expenses and make more taxable distributions than ETFs, which are basically index funds created on demand by marketmakers. That's why John Gay, an adviser at Frisco Financial Planning in Frisco, Tex., is using ETFs to invest 5% to 10% of his clients' cash in real estate and commodities. "I need something that's going to be cost-effective and tax efficient," he says.

GOING FOR GOLD

INVESTORS SEEKING diversification with commodities are just beginning to seek ETFs for the job. Deutsche Bank's DB Commodity Index Tracking Fund, which came out in February, invests directly in futures contracts on six commodities: crude oil, heating oil, gold, aluminum, corn, and wheat. The one drawback is the 2% expense ratio, unusually high for an ETF. For that reason, Gay says he'll wait and likely invest in a similar Barclays Global Investors fund that's in registration at the Securities & Exchange Commission. It's expected to have expenses of just 0.75

Far and away the most popular new niche funds, measured by ass trading volume, is State Street's TRACKS Gold Trust, with more th billion in assets. With gold up 22 the last year, that's not a surprise. blush, this fund does not look like of a diversifier. Over the past year go tracked the S&P closely with a corr of 0.81. (Perfect correlation would b Over longer periods, though, the c tion is much lower, just 0.38 over th three years. In fact, it was slightly tive during the Internet bubble a bear market.

The new niche funds can also be for investors seek play on an indus economic trends. Street's new Homebuilders ET investors buy a ba 21 companies. Bu shares have mor tripled over the p years but have fal this year as the l Reserve's efforts t rates finally slow housing market. housing prices w lapse? Sell this short. But if you higher rates hav all their damage, t is a buy. "Over th term, homebuildi

Sprucing Up Your Portfolio with ETFs

These newer exchange-traded funds offer easy ways to invest in market sectors many portfolios miss. Funds that have low or negative correlation with the Standard & Poor's 500-stock index are good diversifiers.

FUND / SYMBOL	CORRELATION WITH S&P 500*	YTD RETURN**	DESCRIPTION
iShares Lehman TIPS Bond TIP	–0.74	–1.62%	Fixed income fund with inflation protection features
DB Commodity Index Tracking Fund DBC	–0.44	NA	Tracks returns of six commodities including oil and corn
SPDR Homebuilders XHB	–0.20	NA	Sub-sector following homebuilding industry
PowerShares Zacks Small Cap PZJ	0.13	NA	Small companies that beat analyst profit forecasts
Rydex Euro Currency Trust FXE	0.28	NA	Owns euros held in interest-bearing bank account
PowerShares Water Resources PHO	0.60	14.28	Water purification and supply companies
streetTRACKS KBW Bank KBE	0.74	3.10	Follows a popular index of bank stocks
First Trust Dow Select Microcap FDM	0.78	5.45	Stocks selected using five fundamental screens
iShares Russell Microcap Index IWC	0.80	8.80	2,000 stocks representing under 3% of U.S. market cap
streetTRACKS Gold Trust GLD	0.81	5.29	Owns actual bars of gold

*Measure by one year or life of the fund NA= Not applicable through Mar. 13 Data: ALPS Distributors Inc., Morningstar Inc.

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tremendous industry," says Stephen East, an analyst at Susquehanna Financial Group, an institutional research firm in Bala Cynwyd, Pa.

State Street's streetTRACKS KBW Bank Fund, which launched in November, offers another way to play the Fed's moves. The ETF holds stocks of 24 of the nation's largest banks, and it has bounced from around $50 to $55 a share this year. If the Fed ends its rate hikes soon, the ETF could start moving higher.

HOT WATER

THE LATEST ETFs also provide investors an opportunity to add overlooked corners of the market to their portfolios, such as water stocks. The index of water utilities and companies that make filtration and pumping equipment behind the PowerShares Water Resources Portfolio has risen 15% a year over the past five years. Debra Coy, an analyst who follows the sector for Stanford Washington Research Group, says these stocks may be a little pricey now but over the long haul have "great fundamentals due to rising demand for both water supply and water infrastructure around the world."

Microcap stocks, typically companies with capitalizations under $500 million, have been top performers over the past few years, but the sector isn't well covered by regular mutual funds. So Barclays now offers a microcap fund based on the 2,000-stock Russell Microcap Index that sports a 0.60% expense ratio, a full percentage point less costly than the average microcap mutual fund. First Trust Portfolios, a fund manager in Lisle, Ill., also has a microcap ETF, but with a slightly different twist. The fund includes only microcap stocks that pass five Dow Jones screens that look at fundamentals such as price-to-earnings ratios and profit margins. So far this year, the Dow Jones ETF is lagging behind the Russell-based fund by almost three percentage points.

PowerShares has two new small and microcap offerings that use quantitative investment methods developed by Zacks Investment Research in Chicago. The PowerShares Zacks Small Cap Portfolio and similarly named microcap fund are based on research showing that companies that beat analyst earnings estimates are likely to outperform the market. Zacks' system also looks for stocks with few analysts covering them.

If this new round of ETFs doesn't offer what you want, keep your eyes open. Some three dozen are in registration. ■

Where to Go For Growth

A screen of 1,700 companies finds seven prime for a growth-stock comeback. BY TODDI GUTNE

THE LAST TIME INVESTORS got excited about growth stocks was in the last century. Growth stocks—shares of companies whose earnings were growing faster than average—last outpaced the more prosaic value stocks in 1999. Such winning streaks don't go on forever, though, and many think growth stocks are finally going to shine anew. "Many companies more than doubled earnings over the past five years, yet the stocks languish," says Alan Skrainka, chief market strategist at brokerage firm Edward Jones.

That's why we asked Morningstar, the Chicago-based investment-research firm, to find some attractively priced growth companies. Toan Tran, Morningstar's equity strategist, screened a database of more than 1,700 companies for those that are expected to have a minimum of 15% revenue growth and 15% operating income growth over the next five years. Tl mittedly, is a hi which cut the list and it explains w finalists are all to mid-cap stocks companies don't have sustainable rates of that mag

Next, we wante panies with a competitive adv that would all long-term profit s ability. To that em required compa have a "moat," w a judgment call well protected t from rivals. ingstar classifies nies as having moat, a narrow moat, or none at

The moat filter narrowed the 68. The finalists were chosen b their Morningstar ratings—con with a star rating of four or fiv the cut. The ratings, simply put, termined by stock price relativ fair value.

The resulting table (page 107) seven companies. Four are in the care field, two are in the for-profit tion sector, and one is a specialty Screening databases is a good start your research, but you need at qualitative factors, too. Five seven, it turns out, have sold c 52-week highs because of som that makes investors nervous. Sti where opportunity often lies, w potential for a big payout if the disappear.

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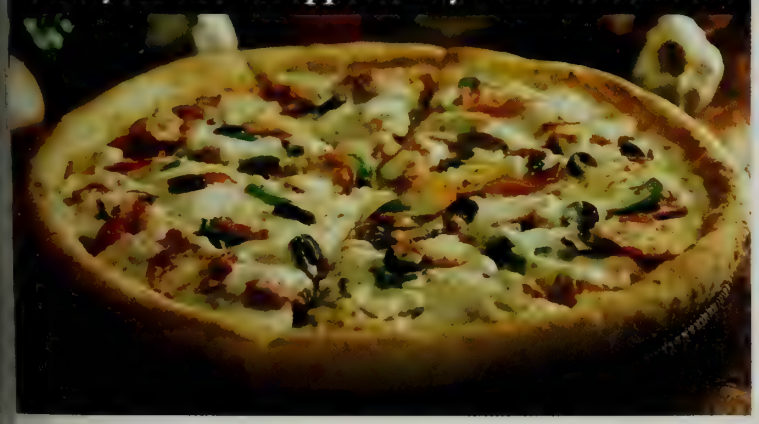

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PANY/ OL	5-YEAR EXPECTED ANNUAL GROWTH RATE REVENUE	OPERATING INCOME	PRICE*	FAIR VALUE	DISCOUNT TO FAIR VALUE
rican Pharm. Partners APPX	33.4%	61.8%	29.95	40	(25.1%)
Healthcare Services AHS	16.9	30.5	18.70	25	(25.2)
lax KMX	15.2	27.3	35.36	49	(27.8)
ate EEEE	15.0	24.5	9.06	15	(39.6)
ic Concepts KCI	16.6	22.9	37.35	57	(34.5)
Pharma MOGN	32.7	NM	16.20	24	(32.5)
er Education STRA	20.5	19.2	97.29	117	(16.9)

2006 NM= Not Meaningful **Data:** Morningstar Inc

c drugs and Abraxane, an impor- ncer drug. What rankles some is pending acquisition of American ence (ABS), a company that is owned by APP's chairman and lling shareholder, Dr. Patrick hiong. Many analysts believe APP id for ABS, and they turned nega- the stock, but, says Morningstar Brian Laegeler, "the underlying ss hasn't been affected."

s profitability is expected to im- significantly after the merger e Abraxane's mar- e higher than those e generic drugs. gstar estimates e $29.95 stock is about 25% below its ue.

It's unique—a r superstore chain o-haggle sale and prices. While new penings are expect- rovide the bulk of pany's growth over the next few ame store sales "should also re- ositive as the company's newer nature and CarMax gains market says Scot Ciccarelli, an analyst C Capital Markets. The ding on is that used-car pricing is cycli- t year, Detroit chose price cuts oduction cuts, which pushed e price of used cars, too. ear pricing is stronger because makers are instead trimming on. That bodes well for CarMax. the premier used-car seller, and p at current valuations of 22 007 earnings," says Vince Gal- a co-manager of Needham Fund which has 1% of its $232 ssets in CarMax. Among the oth- hareholders are William Blair d Lone Pine Capital, which, says r, "is a good endorsement for ."

STRAYER EDUCATION A player in for-profit education, Strayer offers undergraduate and graduate degrees in the classroom and over the Internet. The company is expanding and opening eight new campuses this year. Unlike its much larger competitors, Corinthian Colleges and Apollo Group, Strayer has not had regulatory problems with the U.S. Education Dept. Strayer also has the highest gross and operating margins: 65% and 34%, respectively, vs. 49% and 8% for the industry.

Margins have come down a bit because of increased selling and promotional costs. That's to be expected as the company expands. As one of the smaller players in the for-profit education business, analysts say it has more opportunity to grow. Strayer also tailors its course offerings to working adults over 35 who are looking to advance their careers, a market which is less cyclical than the vocational programs that competitors offer. Enrollment in vocational courses tends to decline when jobs are plentiful.

Health care and education dominate Morningstar's growth picks

What's also important is that Wall Street has a high regard for the company's management. "CEO Robert S. Silberman has tremendous credibility with shareholders because he sets reasonable expectations and meets them," says Trace Urdan, an analyst with brokerage firm Robert W. Baird. Urdan thinks the company's revenue and earnings will grow 18% to 20% over the next three to five years.

If analysts are correct and the long winning streak for value stocks is finally due to end, shareholders of these small, competitive companies could soon be partying like it's 1999.

BusinessWeek online For a look at the other stocks that made the list—AMN Healthcare, Educate, Kinetic Concepts, and MGI Pharma—go to www.businessweek.com/extras

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–Larry Armstrong

SPIRITS

MORE (HIC) TEA, PLEASE

G-AND-T WILL SOON STAND for gin and tea. Darjeeling tea is one flavor in a new line of seasonal gins rolling out this spring. House Spirits, a distillery in Corvallis, Ore., known for its Medoyeff Vodka, concocted the idea with Michael Hebberoy, the young chef behind Gotham Bldg Tavern restaurant in Portland, Ore. First up: GBT Summer Gin, flavored with tarragon, lavender, cucumber, verbena, and orange peel, a twist on Pimm's Cup, a British mixed drink. Come fall, the collaborators will unleash GBT Winter Gin, steeped with a mix of Darjeeling, toasted carob, nutmeg, fenugreek, cranberries, and coriander. The gins are expected to sell for between $35 and $40 per bottle. *–Reena Jana*

REAL ESTATE

Branding the Ranc

CANYON RANCH IS putting the "om" in home. In Miami, more than 85% of t oceanfront condominiums at Canyon Ranch Living have been sold, with pric starting at $1.3 million. The "healthy living community," with interiors desig star architect David Rockwell of the Rockwell Group, is scheduled to open in 2007. The complex features a hotel, several spa-cuisine restaurants, and a 70, square-foot spa and fitness center, as well as personalized programs for nutri weight loss, and disease prevention.

Now the Tucson-based resort is close to finalizing plans to extend the bran high-rise properties in Chicago, Washington, and Dallas, and is looking to ex into New York, Seattle, and San Diego, says Kevin Kelly, president of Canyon which is partially owned by Crescent Real Estate Equities. "These lifestyle communities give people a leg up finding some balance in their lives," Kelly And they are starting young: The average age of a Miami purchaser is 43.
–Laure

TIME OFF

A flock of rarely seen John James Audubon illustrations w at the New York Historical Society now through May 7. An Audubon show has become a rite of spring at the museun each of the Society's 435 watercolors is shown only every 10 years because of light sensitivity. The 2006 show includes the Ivory-billed Woodpecker, the Sandhill Crane, and the Bald Eagle (nyhistory.org).

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BY GENE G. MARCIAL

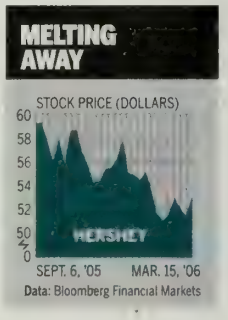
A FRESH BUYOUT OFFER FOR HERSHEY COULD BE HARD TO RES

CORTEX MAY HAVE A BLOCKBUSTER DRUG FOR ATTENTION DEF

WHY THIS COULD BE THE MOMENT TO PICK UP SOME VODAFON

Hershey: A Sweeter Bid?

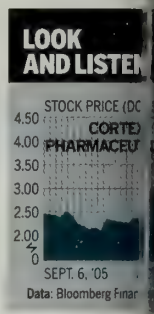
HERSHEY (HSY) CREATED A STIR four years ago when it put itself on the block, attracting an offer from Wm. Wrigley and a joint one from Nestlé and Cadbury Schweppes. Under pressure from Pennsylvania lawmakers, Hershey walked away from the table. Now it might be coming back. "There is talk that Hershey could get a new bid, and it may be difficult to resist," says Michael Metz of Oppenheimer, which owns shares. "With institutional investors no longer passive, management can't turn down an offer without risking a bruising proxy battle," he argues. In its 2002 bid, Wrigley offered 44.50 a share post-split, and Nestlé and Cadbury made an all-cash joint offer of 35. The stock now trades at 52.



The Hershey Trust, benefiting the Milton Hershey School, which owns 31% of the common shares and 78% of voting stock, rejected earlier offers. But some trustees feel a stronger obligation to diversify, says Metz. One reason: Since May, Hershey stock has fallen 21%. Even so, Jeffrey Kleintop of PNC Financial Services, which owns 1 million shares, is unfazed. "We are in it because of Hershey's potential," says Kleintop, who sees the stock at 70 in a year. Richard Joy of Standard & Poor's, who rates the stock a "strong buy," says Hershey is "the best growth story in the food industry," with a strong balance sheet and earnings, expanding margins, and a "dominant position in the fast-growing U.S. confectionery market." Joy sees 2006 earnings of $2.55 a share (including stock-option expenses) and $2.82 in 2007, vs. 2005's $2.28. His 12-month price target: 67. Nestlé and Cadbury declined comment, and the Hershey Trust couldn't be reached.

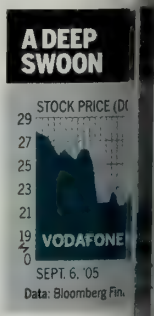
Cortex Draws a Bead On Hyperactivity

ONE CONDITION WALL STREET pays heed to is attention deficit hyperactivity disorder (ADHD), which affects 4 million children and 3 million adults in the U.S. When Cortex Pharmaceuticals (COR) disclosed on Mar. 8 that its lead drug, CX717, showed favorable results in Phase 2 trials for the treatment of adult ADHD, the stock jumped from 3.30 to 4. Cortex says further tests are needed to confirm the early results. Elemer Piros, an analyst at investment outfit Rodman & Renshaw, says Cortex expects to sign a big drugmaker as a partner for CX717, "which has blockbuster potential." Piros says CX717 may be at par with Eli Lilly's ADHD drug, Strattera, with 2005 sales of $552 million. He rates Cortex "outperform-speculative risk," and has upped his target from 8 to 12. Robert Van Roijen of Tox Financial, which owns 1 million shares, says CX717 is also being tested for schizophrenia and memory loss. He puts potential sales in the billions.



Vodafone Has A Nice Ring to It

WHATEVER VODAFONE GROUP (VOD) decides with its 45% stake in Verizon Wireless, some world's largest mobile carrier as a great barg 22. "We like Vodafone whether or not Verizon buys Vo fone's 45% stake in Verizon Wireless," says Gary Stroil Wealth Builders, an investment firm. Speaking of Voda American depositary receipts (ADRs), he says: "We bo at 21, and it pays a 3.4% dividend yield." Not a bad place to be while waiting for a decision on the Verizon sale, worth an estimated $40 billion, says Stroik. Verizon has said it wants to buy Vodafone's stake, and the Street is unimpressed with the rest of Vodafone's business. This is the time to buy, he says, with shares down from 28 in September. Stroik contends Vodafone is cheap, based on its global assets, which include wireless networks with 155 million customers in 27 countries. He values Vodafone ADRs at 27 even before any sale. I Vodafone earning $1.95 per ADR in 2006 and $2 in 20 $1.93 in 2005. Arthur Russell of securities firm Edwar who rates the stock a "buy," says: "The stock already the worst scenario and is way undervalued."



BusinessWeek online Gene Marcial's Inside Wall Street is p businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street firms hold positions in the stocks under discussion. Similarly, they have no i banking or other financial relationships with them.

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et the yoga and stress balls. Help relieve unwanted tension around April 15 with Spiders (SPY), one of the most fficient investment choices around. That's because Spiders represent the stocks of the S&P 500,® only selling rities to reflect periodic changes in the overall composition of the index. And Spider shares trade between buyers sellers on an exchange, just like stocks. So the fund doesn't need to sell securities to pay investors who want to out. These unique characteristics add up to fewer capital gains distributions, and a potentially lighter tax burden. urse, since Spiders trade like stocks, they are subject to similar risks and your usual brokerage commission es. Learn more about Spiders, and stress over something other than tax season for a change. **www.SPDR.com. r symbol Amex:SPY. The entire S&P 500 in every share.**

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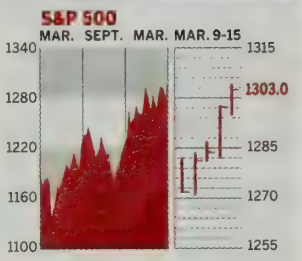
SPD000102

Personal Business Figures of the Week

STOCKS



COMMENTARY

Blowout profits from Goldman Sachs on Mar. 14 and the release of the Fed's *Beige Book* the next day sent the S&P 500 and the Dow to new highs. The *Beige Book*, which tracks the pulse of business, revealed measured growth, giving investors hope that Fed hikes are coming to an end. In response, bonds firmed and equities gained. Among the winners: Boeing and DuPont.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	MAR. 15	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1303.0	1.9	4.4	8.8
Dow Jones Industrials	11,209.8	1.9	4.6	4.3
NASDAQ Composite	2311.8	2.0	4.8	13.6
S&P MidCap 400	782.1	2.4	6.0	16.7
S&P SmallCap 600	382.8	2.9	9.2	16.9
DJ Wilshire 5000	13,112.2	2.0	4.9	11.0
SECTORS				
BusinessWeek 50*	769.9	2.0	3.8	8.3
BW Info Tech 100**	392.0	2.1	3.0	10.4
S&P/Citigroup Growth	614.6	1.5	3.0	6.8
S&P/Citigroup Value	685.1	2.3	5.8	10.9
S&P Energy	398.6	3.3	7.0	18.4
S&P Financials	442.5	1.5	3.8	11.5
S&P REIT	174.8	3.7	14.2	28.4
S&P Transportation	274.6	4.4	9.9	20.1
S&P Utilities	162.7	1.9	1.9	9.0
GSTI Internet	189.6	1.0	-7.6	22.6
PSE Technology	881.5	2.1	5.4	19.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	MAR. 15	WEEK	% YEAR DATE
S&P Euro Plus (U.S. Dollar)	1659.7	4.1	9.
London (FT-SE 100)	5965.1	2.6	6
Paris (CAC 40)	5127.9	3.2	8
Frankfurt (DAX)	5898.5	4.0	9
Tokyo (NIKKEI 225)	16,319.0	4.4	1
Hong Kong (Hang Seng)	15,720.4	1.5	5
Toronto (S&P/TSX Composite)	12,055.6	2.7	6
Mexico City (IPC)	18,999.6	3.3	6

FUNDAMENTALS	MAR. 14	WEEK AG
S&P 500 Dividend Yield	1.78%	1.80%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.0	17.7
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	14.9
First Call Earnings Revision*	-0.67%	-1.20%

TECHNICAL INDICATORS	MAR. 14	WEEK AG
S&P 500 200-day average	1236.9	1234.6
Stocks above 200-day average	67.0%	63.0%
Options: Put/call ratio	0.74	0.80
Insiders: Vickers NYSE Sell/buy ratio	5.46	5.25

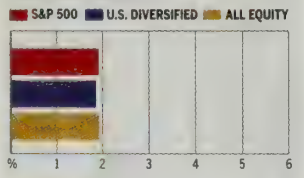
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Steel	15.1	Oil & Gas Refining	59.9
Oil & Gas Refining	12.8	Oil & Gas Equip.	58.9
Agricultural Products	11.3	Human Rsrcs. & Emplmt.	54.1
Oil & Gas Drilling	9.3	Specialized Finance	52.4
Photographic Products	8.9	Constr. & Engineering	48.9

WORST-PERFORMING GROUPS	LAST MONTH %	
Spclzd. Cnsmr. Serv.	-17.9	Automobiles
Tires & Rubber	-10.5	Home Entrtnmt. Sft
Educational Services	-9.2	Motorcycles
Semiconductor Equip.	-8.7	Home Furnishings
Gold Mining	-8.6	Broadcasting

MUTUAL FUNDS

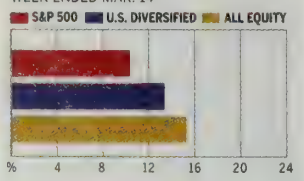
4-WEEK TOTAL RETURN

WEEK ENDED MAR. 14



52-WEEK TOTAL RETURN

WEEK ENDED MAR. 14



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Real Estate	4.8	Latin America	72.2
Europe	3.6	Diversified Emerg. Mkts.	39.6
Communications	3.4	Precious Metals	39.0
Latin America	3.2	Japan	32.6
LAGGARDS		**LAGGARDS**	
Diversified Emerg. Mkts.	-0.5	Domestic Hybrid	8.1
Pacific/Asia ex-Japan	0.6	Miscellaneous	9.3
Technology	1.1	Large-cap Value	10.3
Japan	1.2	Large-cap Blend	10.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFds. Mble. Tlcmms. Inv.	9.8	ProFunds Ultra Japan Inv.	87.7
ProFunds. Real Est. Inv.	8.3	iShares MSCI Brazil Idx.	80.1
U.S. Glbl. Invs. Prc. Mnls.	8.3	T. Rowe Price Latin Am.	79.5
Van Wagoner Emerg. Gr.	7.9	ING Russia A	77.5
LAGGARDS		**LAGGARDS**	
ProFunds Precs. Mtls. Inv.	-7.9	American Heritage Grth.	-42.9
ProFunds. Semicdr. Inv.	-6.2	Potomac Sm. Cap/Sh. Inv.	-30.3
ProFunds Sh. Rl. Est. Inv	-5.1	ProFds. USh. Sm. Cap Inv.	-28.7
Potomac Sm. Cap/Sh. Inv.	-4.3	ProFds. USh. Mid Cap Inv.	-24.7

INTEREST RATES

KEY RATES	MAR. 15	WEEK
Money Market Funds	4.09%	4.0
90-Day Treasury Bills	4.61	4.5
2-Year Treasury Notes	4.68	4.7
10-Year Treasury Notes	4.73	4.7
30-Year Treasury Bonds	4.75	4.7
30-Year Fixed Mortgage†	6.28	6.3

†Ba

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND
General Obligations	3.94%
Taxable Equivalent	5.63
Insured Revenue Bonds	3.97
Taxable Equivalent	5.67

THE WEEK AHEAD

LEADING INDICATORS *Monday, Mar. 20, 10 a.m. EST* » The Conference Board's February index of leading economic indicators is forecast to have retreated by 0.4%. That's the median projection of economists surveyed by Action Economics. The January reading zoomed ahead by 1.1%.

PRODUCER PRICE INDEX *Tuesday, Mar. 21, 8:30 a.m. EST* » Producer prices most likely fell 0.3% in February as energy prices eased a bit. The index rose 0.3% in January. Excluding food and energy, wholesale prices probably rose by 0.2%, after a 0.4% gain in the prior month.

EXISTING HOME SALES *Thursday, Mar. 23, 10 a.m. EST* » Home sales likely edged up to an annual rate of 6.58 million in February, following a January drop to a pace of 6.56 million.

DURABLE GOODS ORDERS *Friday, Mar. 24, 8:30 a.m. EST* » Durable goods orders are forecast to have bounced back in February with a 2.8% increase. During January orders plunged 9.9%, a result in large part of a 68.3% fall in nondefense aircraft orders.

NEW HOME SALES *Friday, Mar. 24, 10 a.m. EST* » February new-home sales probably held at an annual rate of 1.23 million units. In January new-home sales dropped 5% despite favorable weather conditions.

The *BusinessWeek* produ slipped to 269.8 for the Mar. 4 but stood 13.2% previous year leve calculation of the four-w average, the index fell to

BusinessWeek

For the BW50, more in data, and the compone of the production inde www.businessweek.com/mag

ND: Instant Applications Signal the line of Outsourcing and Rise in ROI

ie first bit of memory was stored, com- ecialists have been the intermediary oftware systems and the people who use lay, business solutions pass through a ottleneck of software developers before be implemented. This process excludes xperts from creating software solutions to roblems that they best understand.

of Greater Control

more control over their work, busi- tinely manage operations and projects he-shelf software such as spreadsheets and email. They sacrifice process visibility, consistency, and accountability by misappropriating desktop tools to solve enterprise problems.

Software Development 'Insourcing'

Next-generation software empowers business experts to create enterprise solutions. They build instant applications nearly as easily as they navigate the Internet – point, click, drag, and drop. The database code is generated automatically. Problems of collaboration, process control, and operations management are thereby solved at the point of responsibility *and* expertise.

Finally, the processes that make a company great can be mirrored in software and applied immediately. And the software evolves as inside experts determine new and better ways of doing business. Insight cannot be outsourced. Even if it were, the ensuing application would be obsolete on arrival.

The Rising Wave

Off-the-shelf and enterprise software are not going away. But as the business world changes, those who best understand the problems and possibilities will author their own solutions. Next-generation applications put the best people in control of their business. Watch innovation and ROI climb to new heights.

To read the full report, go to www.technology-reports.com/interneer.asp

INTERNEER INTELLECT

Interneer transforms the development of business applications with Intellect™. Savvy business experts, no longer dependent on IT departments, control all aspects of their success. Fit a software solution to your business. Visit www.interneer.com. Los Angeles, California; solutions@interneer.com, or 800.558.6832.

ing Business Process and nology with Actionable Architecture

ver before, CIOs are faced with to the board of directors how supports business goals, both the future. They are expected to nnology as a cost center and to technology can be better utilized gic asset for business operations. t now understand how their IT upport business initiatives and ness success.

ues are not unique to the business n the federal government, the hen Act and Office of Management and Budget (OMB) regulations mandate that agency IT budgets be awarded according to business cases that spell out how the technology ties to specific goals. In both the commercial and federal worlds, CIOs must have a clear understanding of how their IT aligns to their business goals in areas such as customer service, manufacturing, and e-government.

Enterprise architecture has emerged as a key enabler for business process analysis and action at this enterprise level. Enterprise architecture helps organizations understand the relationships of systems, data, and process to broader business goals. The next evolution, Actionable Architecture, makes the enterprise information understandable to the people across the organization who can apply this knowledge to improve organizational flexibility and responsiveness.

Actionable Architecture adds a strategic foundation for knowledgeable decision-making based on facts. For any organization that wants to understand the relationships of its systems, data and people to its broader business goals, enterprise architecture can provide an aligned view of assets, needs and constraints to drive sustainable success as the organization moves forward.

To read the full report, go to www.technology-reports.com/telelogic.asp

elogic

Telelogic® is a leading global provider of solutions for automating and supporting best practices across the enterprise - from powerful modeling of business processes and enterprise architectures to requirements-driven development of advanced systems and software. Telelogic's solutions enable organizations to align product, systems, and software development lifecycles with business objectives and customer needs to dramatically ality and predictability, while significantly reducing time-to-market and overall costs. • www.telelogic.com/actionable • *By: Jan Popkin, Chief Strategist, Telelogic*

SOFTWARE SOLUTIONS 2006

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Is Your Data Working for You or are You Working for Your Data?

Consider the amount of time you spend gathering data for business intelligence operations. How much time do you spend monitoring competitor web sites for news, product updates or pricing information? Do you regularly search the web for industry news and trends, changes in regulations, or other business intelligence activities? How many people in your department are doing the same sort of activities? How many in the entire organization?

Collecting all this information manually is time consuming. In a recent study, IDC estimated that large organizations may be spending as much as 5.7 million dollars annually in time wasted cutting and pasting information from one source to another.

Not only is there a high monetary cost to manually gathering data, there's also a risk of making poor decisions based on inaccurate or obsolete information. Manually gathering business intelligence is inherently limited in scope. Furthermore, it's tedious, so data is not refreshed as often as needed. This makes it unreliable for strategic decision making.

If manual collection is not the answer,

The solution is to automate your c tion and collection. In the past, require IT to agree to a large, costly took a considerable amount of time Fortunately, this is no longer the cas

As the web has grown into a resource for business intelligence, t harvesting this information have ad matically. The latest data extraction t are robust, easy to deploy and cost e

With today's technology you ca data collection from hundreds of s seamlessly integrate the most-up-to petitive intelligence into your busines All in real-time.

To read the full report, go to

QL2 software

QL2 Software is the leading provider of data extraction and integration solutions that fuel business and competitive intelligence, enter text analytics and pricing optimization strategies. QL2 provides the data that drives the enterprise. QL2 is a member of IBM's U Information Management Architecture (UIMA), was named to KMWorld's Top 100 Companies, and placed high on the list of Fastest Gro Companies in Washington by the Puget Sound Business Journal. 800.750.8830 • 206.443.6836 • sales@ql2.com • www.QL2.c

Service-Oriented Architecture - Even Small & Mid-sized Companies Can Have It

Successful companies, like Amazon.com and Wal-Mart, thrive on real time information from their online commerce, retail operation management, customer relationship and enterprise resource planning (ERP) to maintain their dominant market position.

Amazon.com keeps its edge by fully integrating their online stores with sales order processing, customer maintenance, inventory control, purchase order management, and product fulfillment and delivery. Wal-Mart does it with ongoing investments in state of the art solutions for retail operation, inventory control, customer relationship, supply chain management, and logistics and distribution. They and many other Fortune 500 companies are leveraging the new technology called Service-Oriented Architecture (SOA).

SOA facilitates the exchange of information by providing flexible modules that can be easily integrated and re-used with business software applications. Web technologies are used to provide real-time information between company's front and back end systems as well as with their Business Partners.

To stay in the game, small and mid-sized companies no longer have the luxury of ignoring the SOA technology. With limited IT budgets, these organizations are forced to rely on consultants or third party vendors to implement their business solutions.

Leveraging the power of SOA is a endeavor. Decision makers must be cog service technologies and perform a diligence to ensure they make sound IT

SOA shifts from integration through a loosely coupled web services exchangin via published interfaces. The key benefi

- Reduced cost of deployment & system
- Improved reliability, performance, ar mission critical transactions
- Reusable services which can be rapid meet changing business needs

Technology matters. Without the p standing of the new technologies, compa ing themselves into old technologies that flexibility, and ability to compete for year

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ware Asset Management: of Your Sarbanes-Oxley Compliance

ming the accounting standard for busi-
anes-Oxley (SOX) requires companies to
ntegrity of their financial records, infor-
osure controls and internal controls.
OX's stringent record-keeping standards,
hould automate accounting procedures,
est. But, how can corporate officers cer-
racy of financial records without know-
software used to gather the information
ty and secure? That's why companies
ment a software asset management
am capable of ensuring that the systems
vork work together to capture full, accu-
rate financial information, as required by SOX.

SAM starts with confirming that every company computer is loaded with only licensed and registered software. This initial audit enables companies to detect and delete potentially dangerous, unauthorized copies of software.

Because about one in five software programs used in the U.S. is illegal, no company should assume the legitimacy of the software on its network – particularly considering that under federal law, an organization can be held liable for its employees' actions to the tune of up to $150,000 in fines per copyright infringement.

Not only does illegal software pose liability in terms of copyright, it could also compromise data and network security. It could be outdated, a test copy with bugs, or a copy hiding a damaging virus. A compromised system could mean compromised data and SOX violations.

What's more, if a company were caught with illegal software that it had failed to report as a liability, another SOX violation would apply. SOX violations carry significant jail time – 20 years in some cases – and fines in the millions.

SOX has made it ever more important to check computer security and software, and an easy SAM program that includes a software audit will help protect an organization from faulty programs, federal penalties, network security problems, and ethics violations, while maintaining accuracy and compliance.

To read the full report, go to

BSA® BUSINESS SOFTWARE

Established in 1988, the Business Software Alliance is the foremost organization dedicated to promoting a safe and legal digital world. BSA is the voice of the world's fast-growing commercial software industry. BSA educates consumers on software management, copyright protection, cyber security, e-commerce and more. Available on the BSA Web site are resources for companies to implement software asset management programs, including a free software audit tool. Washington, D.C. • 202-872-5500 • www.bsa.org

lemand Desktop Management: Control in a Mobile World

e world, corporations are becoming
alized as the proliferation of mobile
uch as laptops and next-generation
s have empowered people to perform
ay from corporate headquarters. This
on has significant upside: productivity
ntainment, improved customer serv-
employee retention.
ingly mobile workforce has also elevat-
nce of effective desktop management in
t regulatory reporting requirements,
owntime, ensure software license com-
nprove productivity. Yet desktop management is not an IT core competency, and most corporations view the process as non-strategic, and therefore not a top priority. However, it only takes a single laptop, not properly protected, to put an entire network of PCs at risk, directly impacting business operations and resulting in serious financial consequences.

While most companies have some form of desktop management, the approaches used often involve "point" solutions from a variety of vendors; these solutions fall short in providing a single window into the complete global desktop environment. Even worse, most companies are not able to proactively manage their complete desktop operations or optimize IT resources for strategic initiatives.

As has been seen in the enterprise applications area, on-demand, Internet-based solutions can deliver real-time services cost-effectively to companies regardless of their size or geographic distribution. Similarly, on-demand desktop management solutions, designed around industry best practices, can provide effective, real-time desktop management regardless of the location of the hardware and software. These solutions not only provide businesses with more control over their desktops than ever before, they also enable companies to easily and automatically enforce corporate policies. And, according to the latest industry research, companies can realize annual savings in IT and personnel costs of up to $1,400 per desktop when using effective desktop management practices.

To read the full report, go to

erdream®

A simple Internet connection activates Everdream's industry-leading desktop management services and platform, so all of your desktops and laptops, regardless of location, are "Everdream Protected" - for a surprisingly low cost per user. For more information, visit Everdream at www.everdream.com or call 888-307-7299.

SOFTWARE SOLUTIONS 2006
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Predictive Analytics for Competitive Advantage

Instinct has its place in business, but no one can guarantee that all people have good instincts all the time. Are your people making decisions based upon validated intelligence or are they "making a gut call"? Often, companies purchase Business Intelligence (BI) systems to help address this problem. However, the millions invested in BI is insufficient – decisions are being made looking backwards.

Traditional BI reporting is historical. Companies make decisions based upon what happened yesterday without allowing for present day circumstances or future probabilities. Predictive analytics help organizations look forward. By leveraging sophisticated statistical models companies can test strategic and tactical options using historical and current data while accounting for the risk associated with probable future events and/or circumstances.

Auto insurance companies previously determined the cost of policy premiums based solely upon historical data for similar geographic and demographic profiles. Today, policy premiums are derived through advanced risk models that afford both lower costs to the majority of individual consumers while maximizing the companies' profitability across the entire risk wouldn't drive a car by only look rearview mirror, why would a comp their strategy by only looking backwa

With BI, companies have put a every desktop. With predictive analy nies can now have an expert analy desktop. Important business decisio be made on the basis of predictions intuition. Looking forward, companie ipate and improve their chances of be to market with new products and op The addition of a rigorous, yet flexib analytics and reporting solution is th in enabling business to employ statist petitive advantage across the enterpri

To read the full report, go to www.technology-reports.com/insight

Insightful® Intelligence from data

Insightful Corporation (NASDAQ:IFUL) is a provider of predictive analytics and reporting solutions. Insightful products S-PLU Miner™ and InFact® allow companies to perform sophisticated statistical data analysis, data mining and create superior g numeric and text data. Insightful delivers industry-leading solutions to thousands of companies, governments and research Headquartered in Seattle, Insightful has offices and distributors around the world. For more information, please visit www.insightful.com or call 1-800-5

China: The Next Outsourcing Hotspot For Software and IT Services

Corporate customers recognize that the offshore model has proven to be effective in providing better, faster, and more cost-effective IT and software development services. The numbers speak for themselves: total market revenue for the worldwide software and IT offshore outsourcing market has increased from $6 billion in 2000 to $26 billion in 2005. By 2008, the offshore outsourcing market is projected to grow to $70 billion. Offshore outsourcing enables IT organizations to reduce costs; gain higher productivity from skilled resources and best practices; lower risks through diversification; and increase time-to-market for critical deliverables.

Today, Indian companies dominate the software offshore service market. But there are several factors that are accelerating a shift toward China. Firstly, with the high double-digit growth in customer projects, it is becoming increasingly more difficult to find skilled IT resources in India. This demand is fueling a sharp increase in wage inflation and attrition. China is investing money and resources in technical education that to-date has produced hundreds of thousands of programmers, developers and engineers – in fact, China now produces twice as many graduates as India annually. Secondly, with the increasing dependence on outsourcing in their operating models, customers don't w of their eggs in one basket. Companie nized that they need to diversify to geopolitical risks. China is increasing sidered as a top alternative choice for sourcing due to its vast IT resources infrastructure. And lastly, companies China to expand their operations lo new locations and markets.

China is driving itself to become a si er in the offshore outsourcing marke cost advantages, an educated and skille and state-of-the-art practices, China of a means to improve their operating per business model, and give them a comp tage in a competitive market.

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ACHIEVO.

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)emand Software Puts Expense :rol in Its Place: Where Costs Occur

:s know managing business expenses is aining profitable. Yet, there has been no vay for mid-sized companies to control rough automation.

l demand, or software as a service, is w these companies manage expenses. It ncept that automates numerous manual nsuming paper-based processes.

its to companies are enormous. Financial rated on the fly allow for real-time deci-, enabling superior business performance. policy is embedded in a service and roughout the organization at the point where expenses are incurred. Managers can supervise the financial workflow of their departments and see right away how their business unit is operating to budget. Employees get approvals faster and reimbursement checks sooner.

Finance teams gain control over expenses, and ultimately peace of mind. They are empowered to manage financial expectations rather than chase paper, prove authorizations or enforce company spending policy.

Compliance to financial regulatory policies, such as the Sarbanes-Oxley Act, is another key advantage to on-demand expense control automation. Real-time audit trails and solid internal controls significantly reduce the costs involved in achieving compliance standards.

Effective on-demand applications are Web-native, rather than retrofitted from legacy software to be Web-enabled. This development approach gives companies a number of advantages, including:

- Fast deployment
- Reduced costs and minimal IT support
- Integration with existing IT infrastructures
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The real benefit to on-demand expense control though, is that controlling expenses becomes the company "norm" rather than the focus of running a business.

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ering Government Efficiencies ires a 360° View

ed of elected and appointed official is at their governments expect from an ftware vendor. Whether applying for aining a permit, paying utility bills, or othole, a new generation of public s is demanding new levels of con- ce. Rather than relying on outdated designed to support commercial busi- g agencies are adopting next genera- to create sophisticated 360° views of transactions.

s and rating agencies were first to rtcomings of ERP systems. Given that 70-85% of a local government's balance sheet is in capital assets (e.g. land, buildings, roads, sewers, etc.), many have found that what's on the books doesn't necessarily match what's in the ground. Since traditional ERP applications don't focus on the asset-intensive nature of government, many systems often became obsolete before fully implemented.

A new era has begun in government IT. Sparked by the need for deep domain expertise to deliver operational efficiencies, governments are creating a 360-degree view of citizen transactions to help achieve needed performance gains.

Governments have borrowed heavily from financial institutions, – where banks were first credited with creating a 360-degree view of its customer's deposits, loans, checking and 401K accounts. Similarly, governments have realized the merits of consolidating citizen data, including utility bills, garbage pick-up, business licensing, neighborhood watch, and public safety.

Understanding the challenges of government requires a new level of thinking, and a passion for making operations more responsive to citizen demands.

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Human Process Management: The Next Generation of BPM

Business Process Management (BPM) solutions have helped some of the world's leading organizations efficiently manage their operations, streamline processes and cut costs. They have one of the highest compound growth rates in the software industry because of the strong return on investment they offer to organizations of all sizes, across all industries. However, BPM has been missing a key element: the ability to drill down in the process to view the productivity, progress and resources of the individuals involved.

As a result, Human Process Management (HPM) has emerged as the next generation of Business Process Management. It provides companies with the ability to plan, measure and monitor workflow down to the individual level in real time – maximizing the full value of an organization's resources. Companies such as Capgemini, Accenture, PriceWaterhouse-Coopers, BASF and British Petroleum have successfully leveraged HPM to proactively manage their businesses, reduce costs, increase efficiency and improve productivity throughout their organizations.

HPM is well suited for organizations with all types of people-intensive processes. For example, it enables business process outsourcers, shared service centers, and human resource administration to adjust resources to improve the ance against service level agreement performance indicators. A recruiting s ter, for example, can use HPM to effic qualified candidates, assign and priorit for screeners to review, and schedule resources required to conduct intervie

On-demand HPM applications pr greater value because of the significan investment (ROI) they offer. On-demar are rapidly deployed; require minimal install and maintain; and are easily a internal and external employees and p

HPM is quickly catching on as the r tion of BPM, helping companies ma greatest resource -- their people.

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Technology Trends Learned From Banking

American banks have taken a controlled approach to new technology adoption due to the risk sensitivity of their business processes. But their cautious approach has served these institutions well, giving them access to automation without jeopardizing critical operations. In the process, the banking industry has revealed some evolving trends that will ultimately change the way entire industries operate.

Open Data/Messaging Standards: Several industries have adopted uniform data/messaging standards in order to create utilities that reduce costs. Now, a broader movement seeks to create standards across industries like financial services/banking. If successfully deployed, such standards could make it easier and more affordable to implement new technologies, merge firms from different sectors and manage alliances.

Multi-Channel Integration: Consolidation in banking has led to the need to integrate similar product silos when companies merge. Now, banks are leveraging robust integration technology to seamlessly connect diverse marketing and distribution channels within their organizations. This gives institutions a 360-degree view of their customers, helping them increase share-of-wallet and enhance the customer experience.

Controlled Legacy Conversions: Instead of ripping and replacing older enterprise systems, banks are using middleware to gradually move ty off legacy platforms. This lowers con as well as development and IT manag while boosting application flexibility an

Centralized Compliance Technolog ly regulated institutions, American invested in new tools that provide com itoring across the enterprise. Using Bus Rules Management engines, these techn banking institutions standardize proces sioning criteria to reduce the threat o missteps and protect brand equity.

As these trends gain momentum, ent will experience tremendous performan cial gains. The potential upside will shift change industries.

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-

tories (ABT) 12

cience 104
rmaceutical

re (AHS) 104
68
) 32, 35
APOL) 104
9
VT) 60
her 78

L) 54
rfish (AQNT)

BEAS) 36
102

way (BRK) 78
68, 76
34

I) 52

es 43
BAB) 12

pes (CSG)

58
wing 108
) 30
14

0
ers 52
SCO) 43

nery 43
es (COCO)

te (CEI) 108
)

43

D, E, F

DB Commodity Index Tracking Fund (DBC) 102
Dell (DELL) 19
Delta Air Lines (DAL) 52
Deutsche Bank (DB) 102
Diffusion Group 68, 74
Digitalmill 43
DoubleClick 54
Dow Jones (DJ) 102
Dubai Ports World 10, 30, 38, 46
Eastman Kodak (EK) 98
Educate (EEEE) 104
Edward Jones 104, 110
El Al 36
Eli Lilly (LLY) 110
Emerson Climate Technologies 32
Emirates 46
ExxonMobil (XOM) 124
Fannie Mae (FNM) 30
First Trust Portfolios 102
Ford (F) 30, 54
Forrester (FORR) 60
Freddie Mac (FRE) 30
Frisco Financial Planning 102
Fujifilm (FUJIY) 98

G, H, I

Gap (GPS) 52
Gen Re (BRK) 78
GfK Market Measures 12
GM (GM) 30, 32
Goldman Sachs (GS) 30, 78
Google (GOOG) 12, 52, 54, 64, 68
Haier 68
H&M (HMB) 68, 70
Hartford Financial (HIG) 14
Hershey (HSY) 110
Hewitt Associates 32
Hewlett-Packard (HPQ) 19, 98
Hibernia (COF) 30
Home Depot (HD) 14, 32
Honda (HMC) 32
Hyundai 30
IBM (IBM) 68
IDEO 68
Intel (INTC) 19, 32

J, K, L

Jackson Enterprises 68
Keefe Bruyette & Woods 40
Kia 90
Kinetic Concepts (KCI) 104
Knight Ridder (KRI) 24, 30
Kohler 60
Kraft Foods (KFT) 54
Langely Partners 12
Lehman Brothers (LEH) 30
Lone Pine Capital 104
Lowe's (LOW) 14
LSE 40
L-3 Communications (LLL) 38
Lukoil (LUKOY) 40

M, N

Majestic Research 40
Marsh & McLennan (MMC) 78
Marvel (MVL) 68
McClatchy (MNI) 24, 30
McKinsey 32
MEC Interaction 54
MediaNews Group 24
Merck (MRK) 12, 30
MGI Pharma (MOGN) 104
Microsoft (MSFT) 30, 52
Minerva Software 43
Mobile TeleSystems 40
Mohawk (MHK) 86
Morningstar (MORN) 104
Motorola (MOT) 32, 44, 68
MSN.com (MSFT) 54
MySpace.com (NWS) 52
Napster (NAPS) 74
NASDAQ (NDAQ) 30, 40
Needham Growth Fund (NEEGX) 104
Nestlé (NSRGY) 110
Nickelodeon (VIA) 52
Nielsen Media 60
Nikon 98
Ningbo Bird 44
Nintendo (NTDOY) 30
Nissan (NSANY) 68
Nokia (NOK) 32, 44, 68
Norson Telecom 44
North Fork (NFB) 30
North Olmstead 12
Northrop Grumman (NOC) 36
NYSE (NYX) 40

O, P, Q

Ocean Shipholdings 38
Olympus (OCPNF) 98
Oppenheimer 110
Panasonic 98
Pentax 98
Pfizer (PFE) 10, 12
Pixar (PIXR) 68
PNC Financial (PNC) 110
Pottery Barn (WSM) 32
PowerShares Water Resources (PHO) 102
PricewaterhouseCoopers 54
Procter & Gamble (PG) 54, 68
Publicis Groupe(PUB) 54
Quantico Partners 12

R, S

RAND 9, 36
Raving Brands 68
RBC Capital Markets 104
Rentrak (RENT) 60
Revenue Science 54
Robert W. Baird 104
Rockwell Group 108
Rodman & Renshaw 110
Royal Philips (PHG) 68
Samsung 32, 68, 74
S&P (MHP) 110
Sanofi-Aventis (SNY) 10
Schering (SHR) 30
Schering-Plough (SGP) 14
Science Applications 38
Sepracor (SEPR) 10
Siemens (SI) 32
Sirius Satellite (SIRI) 74
Sistema 40
Sling Media 76
Sony (SNE) 30, 98
SPDR Homebuilders (XHB) 102
Stanford Washington Research 102
Starbucks (SBUX) 52
Starr International 78
State Street (STT) 102
Strategy Analytics 44
Strayer Education (STRA) 104
streetTRACKS Gold Trust (GLD) 102
Susquehanna Financial 102

T, U, V

Target (TGT) 32, 52
TargetRx 12
TCL 44
37signals 72
Timbuk2 108
Time Warner (TWX) 60, 64
TiVo (TIVO) 60
Tox Financial 110
Toyota (TM) 30
Tralliance 12
Tyson Foods (TSN) 86
UTStarcom (UTSI) 68
Verizon (VZ) 14
Virgin Group 68
Vodafone (VOD) 110

W, X, Y, Z

Wal-Mart (WMT) 32, 35, 86
Walt Disney (DIS) 12, 52
Wealth Builders 110
William Blair Funds 104
Wipro (WIT) 68
Wm. Wrigley Jr. (WWY) 110
Wynn Resorts (WYNN) 10
XM Satellite Radio (XMSR) 74
Yahoo! (YHOO) 54
Yankee Group 60
Yongjin Group 32
Zacks 102
Ziggs.com 52

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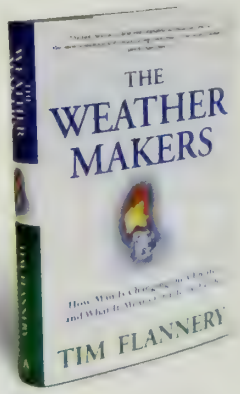
No Climate for Inaction

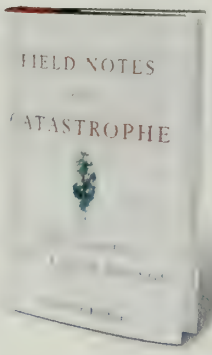
THE WEATHER MAKERS How Man Is Changing the Climate and What It Means for Life on Earth
By Tim Flannery; Atlantic Monthly Press; 357pp; $24

FIELD NOTES FROM A CATASTROPHE Man, Nature, and Climate Change
By Elizabeth Kolbert; Bloomsbury; 210pp; $22.95

As scientists reckon with fast accumulating evidence of climate change, some observers have become resigned to a cataclysmic future. Others deny that we are altering the climate at all. Yet a few writers are synthesizing what has been learned, in the belief that better understanding and public involvement can help fix what's broken.

That's the mission of two of the best recent books in this field. In *The Weather Makers: How Man Is Changing the Climate and What It Means for Life on Earth*, Australian scientist Tim Flannery offers a compelling, far-flung tour through the history and science of the Earth's climate, with disturbing conclusions about what may come next. In *Field Notes from a Catastrophe: Man, Nature, and Climate Change*, Elizabeth Kolbert, a staff writer for *The New Yorker*, keeps the science to a minimum and offers a more accessible exploration. Both writers agree with Kolbert's statement that "In legitimate scientific circles, it is virtually impossible to find evidence of disagreement over the fundamentals of global warming" or mankind's role in it.





Don't be misled by Flannery's action-thriller title. It refers to how man-made agents are altering millennial rhythms of the weather in ways that we are beginning to understand but cannot control. Geological records show us that in the past, sudden climate shifts have more than once wiped out large percentages of Earth's species. This time, man may be no exception: "If humans pursue a business-as-usual course for the first half of this century...the collapse of civilization due to climate change becomes inevitable," he writes.

For all of its technical sophistication, Flannery's book is a surprisingly passionate work, finely balanced between science and personal experience. The opening lines record the author's reflections on a visit to the high grasslands of Papua New Guinea some 25 years ago. This equatorial island north of Australia is a hothouse of one-of-a-kind creatures, such as meter-long rodents and long-beaked birds, and it remains largely unexplored by humans.

But not untouched. Even 25 years ago, Flannery now realizes, signs of the effects of man's rising CO_2 output were evident. The jungle had begun to encroach on the gras from lower altitudes, a sign that the cool, mist-soaked and its countless, highly specialized flora and fauna we off, giving way to the hotter, less wet conditions of low Since then such changes have multiplied. The warmin drying out of Costa Rica's cloud forests has already do carnival-colored toads. In the Arctic, disappearing pac decimating polar bear populations along with a host o that depend on the remains of the bears' prey.

Climate change is already beginning to alter mank environment. For example, though viewed as a temp problem, the decades-old drought in Saharan Africa a permanent shift of rain patterns and higher temper In Darfur one can see a foreshadowing of future clim related conflicts: Driven by the desertification of onc grasslands, herders are fighting for space. Will Europe react pea Flannery asks, if, as many mode suggest, the Gulf Stream shuts d sends millions of Scandinavian n southward, fleeing their sudden frozen homelands?

Kolbert's book covers some of ground as Flannery's and has eq discouraging implications. Origi published as a three-part series i *New Yorker*, her work brings aliv plight of those affected, from Ala Eskimos uprooted by melting pe to rare butterflies in Brit doomed to ever-shrinki habitats. Refusal to resp such obvious evidence, Kolbert, is "deeply, even obscenely, self-serving."

Two books on why it's time to tackle global warming

Action by concerned consumers is crucial to corporations and gover respond, Flannery argu Replacing a gas guzzler with a hybrid vehicle can cu emissions by up to 70%. But perhaps the most vital one that is tentatively under way, is to "de-carboniz power grid: Replace coal-fired plants with cleaner n units en route to nuclear and renewable sources. Ur utilities to make green power available can spark th

While Kolbert's work illuminates the question of change in a more readable, less scientific narrative, is in many ways a more complete and profound wor final message: Don't be paralyzed by indifference or begin to act personally and politically. Now. ■

–By A

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Ideas The Welch Way

BY JACK AND SUZY WELCH

Keeping Your People Pumpe

In our business, the biggest challenge we have today is motivating our people. What's the best way to do that?
—Vijay Naik, Gaborone, Botswana

Besides money, you mean? We assume you do, because as a boss, you surely have seen how effective money is in lighting a motivational fire—even in employees who claim money doesn't matter to them. Indeed, money's power to energize people is so tried and true we won't dwell on it. Nor will we talk about two other no-brainers: interesting work and enjoyable co-workers. You already know how effective they are in getting people to invest heart and soul in their jobs.

So what else can you do? Plenty. Here are four more motivational tools—all nonmonetary and each effective.

The first is easy: recognition. When an individual or a team does something notable, make a big deal of it. Announce it publicly, talk about it at every opportunity. Hand out awards.

When we suggest that to business groups, almost inevitably someone expresses concern about the people not being recognized: They might be hurt or de-motivated. This nonsense indulges the wrong crowd! If you have the right people—competitive, upbeat, team players—public recognition only raises the bar for everyone.

One more note on recognition, in particular when it's in the form of engraved doodads: They can never be given in lieu of money. They are an addendum. Plaques gather dust. Checks can be cashed. And employees know the difference in their bones.

The second tool, celebration, should be easy but isn't. We often ask audiences if they think their companies celebrate success enough, and typically no more than 10% of the crowd says yes. What a lost opportunity. Celebrating victories along the way is an amazingly effective way to keep people engaged on the whole journey. And we're not talking about celebrating just the big wins. We mean marking milestones such as an important order or a new way to increase productivity. Such small successes are chances to congratulate the team and boost spirits for the challenges ahead.

Celebrations don't need to be fancy. They're really just another form of recognition, but with more fun involved. Like rolling out a surprise keg one afternoon, tickets to a ball game, or sending a couple of high performers and their families to Disney World. Whatever turns their crank.

Which brings us to what celebration is not. It's not dinner with you. Almost nothing strikes terror into the hearts of employees more than a boss saying: "Great job! I'm taking everyone to Mama Maria's tonight." Look, your peopl all day with you, and while they may like you, it's not motivating to be rewarded with a forced march to an no matter how great the meatballs.

The next motivational tool is really powerful, but it only be used if you're absolutely clear about your mis Now, you may be thinking: "Aren't all bosses clear ab mission?" Alas, too often they're not. In the course of travels, we've discovered that many leaders are so bus the daily grind that their missions fall by the wayside

To move forward, a team has to understand and bu where it's going. It needs a collective sense of purpos that's exactly what a great mission gives you, a bold, inspirational creed. A mission allows bosses to say: "" the hill, let's take it together." Now, that's motivation

The final motivational tool is probably the most dif implement. Yes, many great leaders have it, but for th seasoned, it's hard to get just right. We're talking abo balancing achievement and challenge. People are mo when they feel as if they are at the top of the mountai if they are still climbing it. Simply put, who create jobs with just the right push pull have a real competitive advantage.

Beyond the obvious incentives: Four smart ways to light a fire

Now, back to money.

Of course, some people aren't move financial rewards, but they rarely gravi toward business. That's why when you about motivation, you need to think ab money first. It's not always how much people, though. Sometimes it's how mu give them relative to their peers. We re asked an investment banker we know his year went. While he was pleased wi bonus, he was just as excited by how it measured up to the other top rainmakers in his firm is a way of keeping score.

That said, even investment bankers—at least, some them—care about more than money. In fact, very few people will stay in a job just for the payback. They als to feel that they matter and that what they do for eigh a day or more means something. You can fulfill those with open appreciation, a sense of fun, an exciting sh goal, and individual attention to the challenge of each a tall order for any boss, but the returns are incalcula

Jack and Suzy Welch are co-authors of the best-seller Winn *(HarperCollins 2005). They look forward to answering you questions about business, company, or career challenges. Please e-mail them at* **thewelchway@businessweek.con**

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BY SENATOR RICHARD G. LUGAR

Thinking Outside the Barrel

In a remarkable moment during the State of the Union address, Preside George W. Bush caught the attention of the nation with five words: "America is addicted to oil." Soon after the speech, I talked to the Presi about energy, and he admitted that he had not anticipated the impact o that statement or that some commentators would find it incongruous.

I believe he is sincere in wanting to focus efforts more on pursuing alternative energy sources. But his Texas roots, his high-profile advocacy of opening up the Arctic National Wildlife Refuge to drilling, and other associations with the oil industry have created long-standing public impressions that the President is an oilman who believes in the oil economy.

Bush's predicament mirrors the nation's own love-hate relationship with oil. For decades the energy debate in the U.S. has pitted so-called pro-oil realists against idealistic advocates of alternative energy. The pro-oil commentators have attempted to discredit alternatives by saying they make up a tiny share of energy consumed and that dependence on oil is a choice of the marketplace. They assert that our government can and should do little to change this. Former Exxon CEO Lee Raymond echoed such reasoning in 2005, when he noted that in 25 years, even with double-digit growth rates, alternatives like wind and solar power will still provide less than 1% of the energy needed to meet worldwide demand. "I am more interested in staying focused on the 99%," he said.

YES, ADVOCATES of alternative energy must resist the temptation to suggest that energy problems are easily solved. They are not. Relieving our dependence on oil is going to take huge investments of time, money, and political will. But the difficulty of solving the problem doesn't make doing so any less necessary. With less than 5% of the world's population, the U.S. consumes 25% of its oil and will spend about $320 billion on oil imports this year. Most of the world's oil is concentrated in places either hostile to U.S. interests or vulnerable to political upheaval or terrorism.

Given that sobering outlook, I believe the balance of realism has passed from those who argue on behalf of oil and a laissez-faire energy policy relying on market evolution to those who recognize that life in America will be far more difficult in coming decades unless there is a major reorientation in the way we get our energy. No one who cares about U.S. foreign policy and long-term economic grov ignore what is happening in Iran, Russia, or Venezuela no one who is honestly assessing the decline of Americ leverage around the world due to our energy depender fail to see that oil is the albatross of U.S. national secur

We need an urgent campaign, led by a succession of committed Presidents and Congresses, to promote alte sources. We could take our time if this were simply a n managing an industrial conversion to more cost-effect technologies. Unfortunately, U.S. dependence on ever- fossil fuels has already created conditions that threate security and prosperity and undermine international s

The oilman in the Oval Office is the ideal advocate for alternative energy

Most of the world's oil and gas is not controlled by those who respect market f Foreign governments control up to 77% c oil reserves via national oil companies, w prices through production decisions—an easily shut off the taps for political reaso

I am not suggesting that markets won someday come into play to stanch Ameri dependence. Eventually, because of scarc terrorist attacks, market shocks, and fore manipulation, the high price of oil will le enormous investment in, and political su for, alternatives. The problem is that such investment won't happen overnight. Eve did, building supporting infrastructure a changing behavior could take decades. I words, by the time a sustained energy crisis fully moti the market, the resulting investment will come too lat prevent the dire consequences of our oil fixation. This very essence of a problem requiring government actio

That's why I hope we will look back on President B declaration about oil addiction as a seminal moment i history. Like President Richard M. Nixon using his anticommunist credentials to open up China, Preside could use his standing as an oilman to lend special pow advocacy of renewable energy. Such action is long over

Richard G. Lugar (R-Ind.), *chairman of the Senate Fore tions Committee, has represented Indiana in the Senate si*

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Toyota U.S. Operations
Plants 10
Jobs 386,000*
Investment $13B

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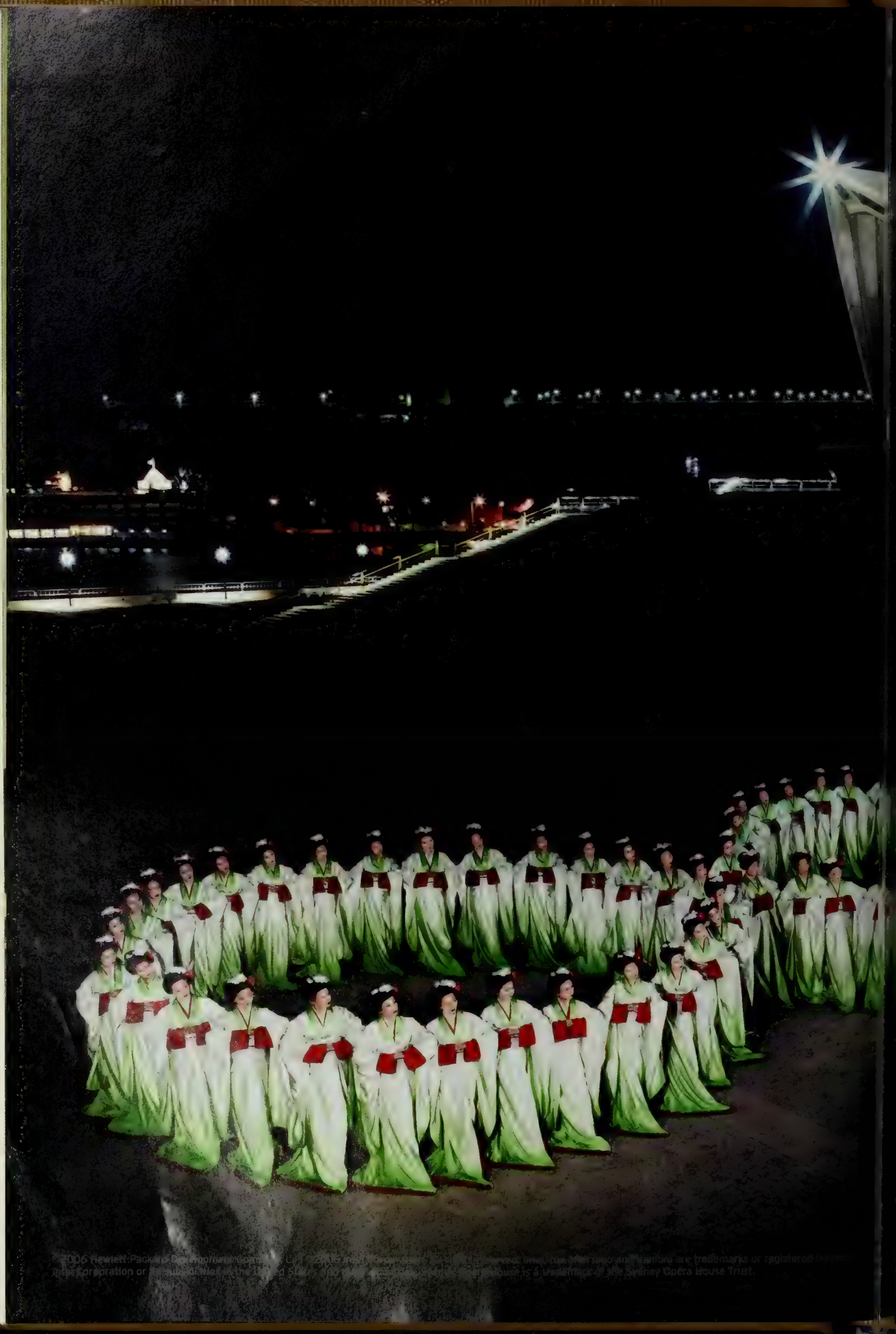
What makes this story so exciting is that quite a few of Toyota's plants are growing. Just like the one in Buffalo. Just like the company called Toyota. It's a true story, a happy story, and best of all, a story with no end in sight.

TOYOTA
toyota.com/usa



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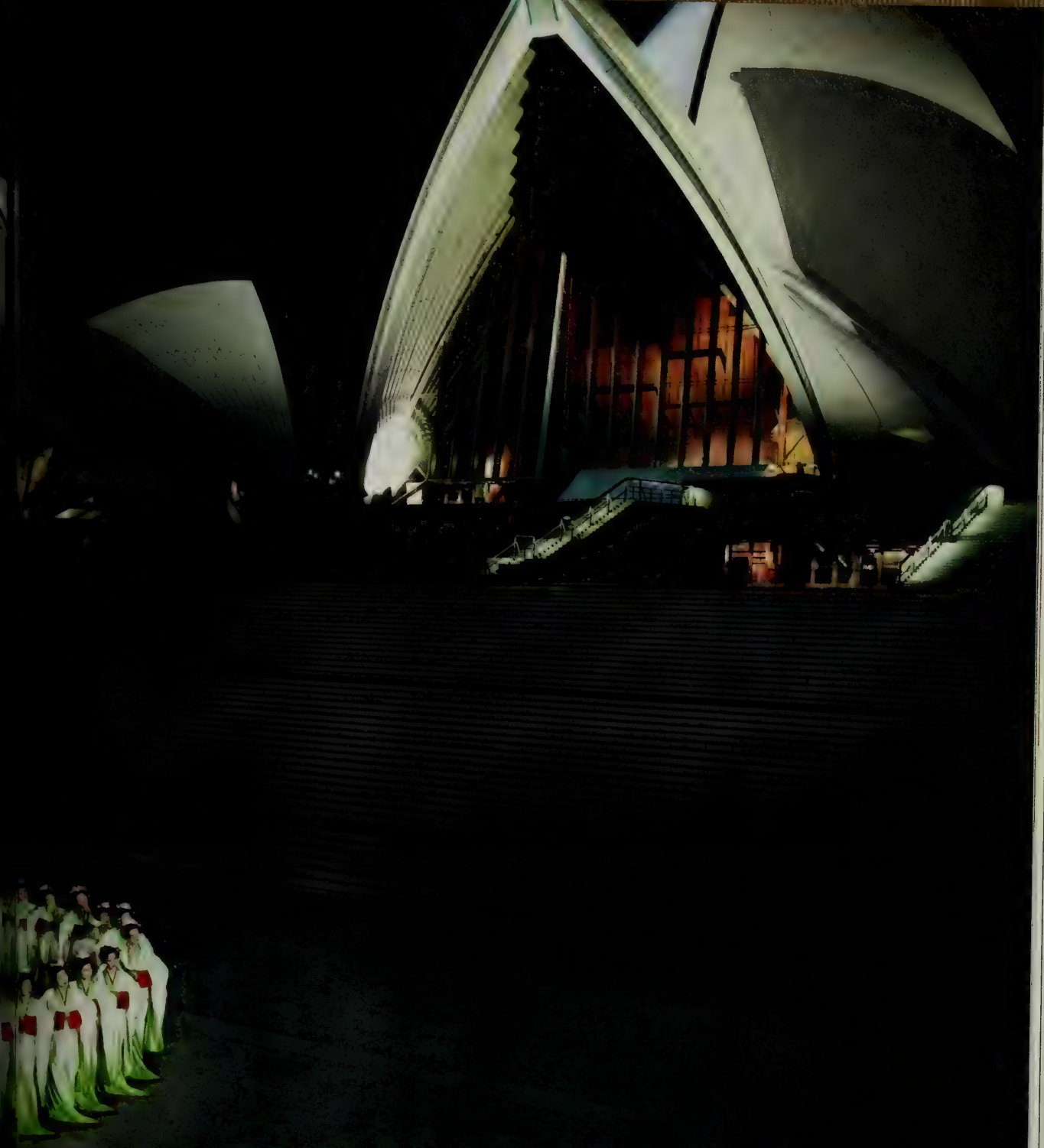

How the show always goes on. To a packed house.

Whether it is "Madama Butterfly" or Michael Bublé, every ticket at Sydney Opera House is a hot one. That's why they chose HP Integrity servers with Intel® Itanium® 2 processors. Now twelve times as many customers can access the ticketing system simultaneously, and downtime is a distant memory. Norman Gillespie, CEO says, "Maintaining our reputation is crucial. HP Integrity servers help ensure our customer experience is virtually flawless." itanium-integrity.com

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intel

hp invent

THE BUSINESSWEEK FIFTY

Our Tenth Annual Ranki

64 The Best Performers
With world oil prices high, the ener sector's strong showing in this yea ranking of the BusinessWeek 5 as no surprise. But a host of companies—from Apple Staples—have scored b using technology, des clever marketing to intense customer

68 IPods, Sure, But Do
Apple needs growth ir computers to stay on

70 Squeezing Oil fro
Schlumberger's tech indispensable in a s

72 White-Hot Gold
Savvy trading stra driving its profits

74 Two Ways to Bu
Horton fixes on gr stresses return on

76 FedEx: What G
An early pioneer i outsourcing to Asi

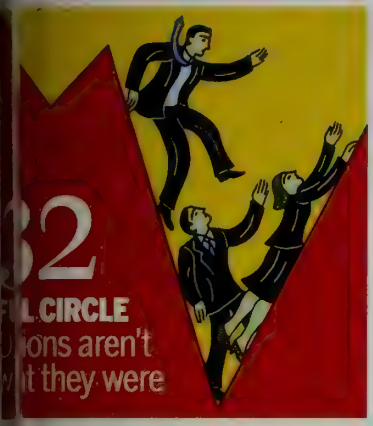
78 Hot Prospects: BusinessWeek 50 St
It's a field worth min carefully—for some s strong outlooks

82 The Ranking
IPod mania being what i leads the list. But beyond surprises lurk in this year's

103 Inside the Ranking
The numbers we crunched, and

BusinessWeek

April 3, 2006



Business Week

s You Need To Know
Motors; Bernanke speaks; oft; Citigroup; Google; and more

s: Analysis ommentary

the Option Became Optional
ut that stock options' great ment was to hike executive pay

ul Dodgers of Earnings Season
tions expensing is avoided

osoft's Slo-Mo Scramble
ints up its need to innovate faster

Proxy Adviser Shifting Priorities?
s a CEO despite good governance

t You Foresee Is What You Get
expectations and Fed strategy

zeera's English-Language Debut
lobal minus a U.S. distributor

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g German startups a boost

a Has Its Own E-Gavel
site TaoBao keeps eBay at bay

n Fledges More Legal Eagles
schools graduate their first class

lobal Coverage:
itional insights into European an business, please go to isinessweek.com/globalbiz

rnment

ington Outlook
nhofe's climate of confrontation

Finance

48 I'll Have a Latte, and a Mortgage
Banks learn to market like retailers

The Corporation

50 The Second Coming of Copper?
Prices are up, boosting Phelps Dodge

Information Technology

52 Innovation: The View from the Top
IBM's Palmisano on CEO strategies

54 Qualcomm's Bid to Break Into TV
The first broadcast service for cell phone

55 Call It a Sell Phone
Advertisers are lining up to go mobile

56 West Coast VCs, East Coast Rules
Azure's Street refugees swear by research

Marketing

106 Adidas' World Cup Coup
U.S. soccer fans will see only its ads on TV

Social Issues

108 A Turnaround Ace for New Orleans
Bill Roberti takes on the school system

Managing

110 Seagate's Morale-athon
The tech giant's team-building blowout

Science & Technology

113 Developments to Watch
Air Force medical info; the bar code's new tricks; mighty morphing microbes

Personal Business

114 Cooking Up a Dream Vacation
Epicurean travelers are fueling a boom in hands-on culinary programs

116 We're All a Little ADD
A shrink talks about activity overload

118 A Third Way for Cancer Patients
For-profit centers have their own benefits

120 Is Your Hospital Heart Healthy?
Checking the ratings for cardiac care

122 The Currency Game: Home Edition
New Web sites make forex affordable

124 Personal Business Plus
Georgia's Jepson Center; college savings plans; the leaner red meats

Columnists

24 Wildstrom: Technology & You
Laptops with built-in cellular broadband

26 Fine: Media Centric
Time Inc.'s odd bid for the cubicle crowd

27 Cooper: Business Outlook
The economy's temperature isn't yet clear

126 Marcial: Inside Wall Street

134 Bartiromo: FaceTime
An audience with Saudi Prince Alwaleed

Ideas

132 Books
Easterly: *The White Man's Burden*

136 Outside Shot: David Huether
The case of the missing jobs

Voices of Innovation

22 Voices of Innovation
Fujio Masuoka, memory chip maverick

Features

13 UpFront
18 Readers Report
20 Corrections & Clarifications
128 Figures Of The Week
130 Index of Companies

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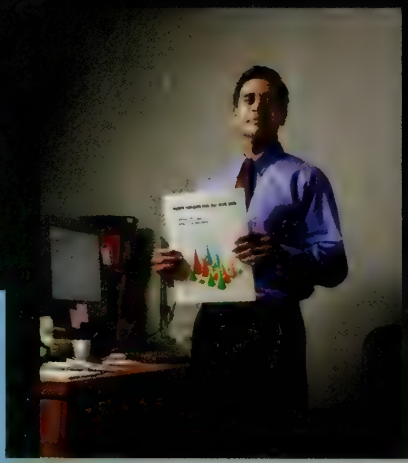

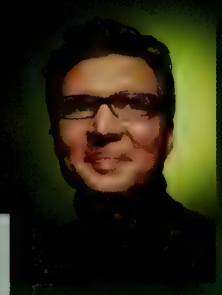

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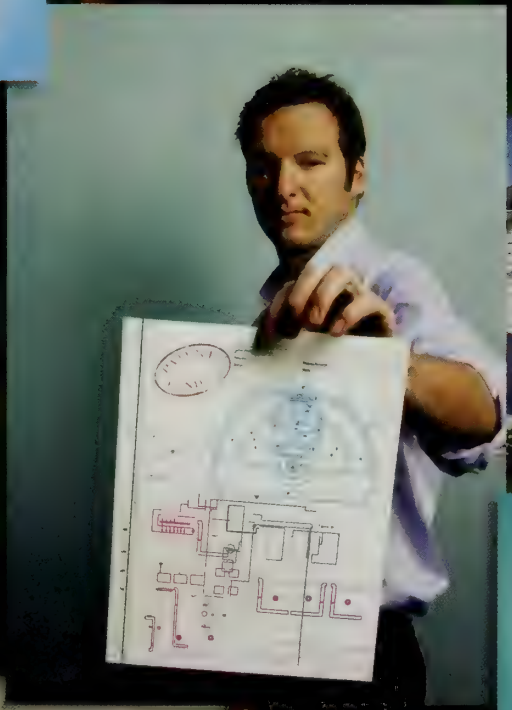

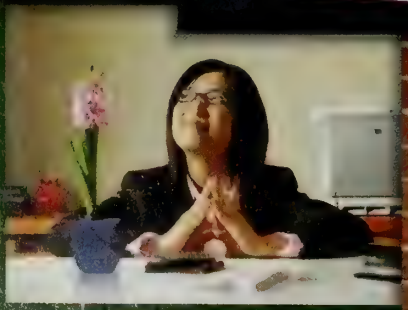

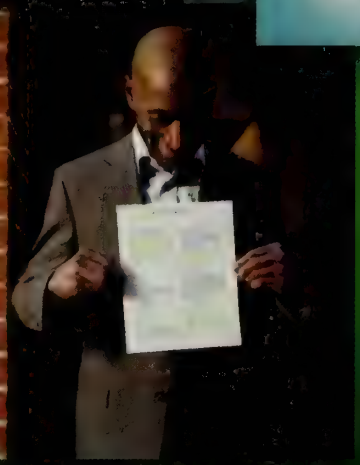

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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What's Hot This Week A

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Water Sparkles

Even the cold, fresh H_2O that comes flowing out of mountai springs is a hot commodity these days, according to our **Onli Special Report.** That's why coffee giant Starbucks bought Eth Water, a small purveyor of bottled water previously sold mai yoga studios and health food stores. Ethos founders Jonatha Greenblatt and Peter Thum discuss their plans for expansio Innovation & Design Channel Editor Jessie Scanlon. Of cou even if Ethos is wildly successful, it's just a drop in Starbuck massive revenue stream, so investors need to find plays that purer. In **Dipping into Water Stocks,** we identify five companies offer a chance to profit from collecting, distributing, and purifying the stuff. Perhaps the biggest opportunities lie in cleaning up storm water. Under a mandate from the Environmental Protection Agency, municipalities are spenc billions on tunnels, tanks, and drain purifiers. To see just h wise you are about water, take our interactive quiz. You'll fi of this and more at **www.businessweek.com/go/water06**

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UP Front

"This kind of thing will undermine the deterrence idea of white-collar crime prosecution."

–University of Texas law professor Henry T. C. Hu after a federal appeals court reversed Frank Quattrone's obstruction-of-justice conviction, to The Washington Post

BY DEBORAH STEAD

NET GOOGLE REALITY CK PRINT

'S EFFORT to roll its ing juggernaut digital is struggling. may not be good print media. In y, Google auctioned ace it had purchased

two dozen es, from **Martha iving** to **Road & Track.** ion, the latest twist in nth experiment with nd reselling print open to thousands of rs. But Google was extend the deadline to lure more buyers.

The tepid demand was apparent in some winning bids. Nicholas Longo, CEO of **CoffeeCup Software,** which makes tools for creating Web sites, bid just $4,600 for each of three half-page ads in *Martha Stewart Living*. The magazine's rate card pegs the price of a half-page ad at more than $59,000. Longo wound up paying at least 93% less than that. Neither Google nor *Martha Stewart Living* would reveal what Google originally paid for the space, but it didn't get a similar discount.

Google can certainly digest a loss of tens of thousands of dollars. A spokesperson says the outfit is more concerned with testing the auction process than with any financial return. But the results may indicate that the true value of a page of print lags its list price, at least in the eyes of Google's advertisers, who are used to high-return search engine campaigns. *–Ben Elgin*

IG PICTURE

ERS AND STUBBLE

in the cubicle: ecommuters 0 countries ed in on whether

	WOMEN	MEN
E PRODUCTIVE	46%	52%
TO BATHE	44	30
TO DO HOUSEHOLD TASKS	38	18
Y ABOUT NOT BEING IN THE OFFICE	11	8

FLU FEARS

I Know Why the Caged Bird Sings

SELLING ITSELF AS a haven from bird flu, the U.S. poultry industry has a point to make, but it's a tricky one: Its chickens are raised in "contained facilities." Unlike some Asian birds, they don't go outside, where they could have contact with their wild, diseased brethren. As animal rights groups have long complained, the vast majority of the 10 billion chickens produced annually are confined in so-called factory farms.

So how do you market something that conjures images you would rather avoid? Very carefully. John Lea, group vice-president at **Tyson Foods,** makes the practice sound almost benevolent. "Our commercial birds are raised in facilities that protect them from wild birds and predators," he explains, adding that the U.S. poultry industry is "the most protected in the world from accidental transmission." And Richard Lobb of the **National Chicken Council** says that "keeping flocks indoors is the best way" to avoid disease. Whether or not that's true is open to debate. Tyson, for one, is not taking any chances, having increased testing and security measures. Meanwhile, groups such as **People for the Ethical Treatment of Animals** are fuming over the efforts to promote factory farms as a form of biosecurity. *–Diane Brady*

UP Front

PAY CHECK

THE WHOLE TRUTH ABOUT OPTIONS

FOR A PREVIEW of how CEO pay may be disclosed in the future, take a look at **Bank of America's** latest annual proxy. The company is one of a few listing "total compensation" for top brass ahead of new **Securities & Exchange Commission** rules expected to kick in next year. (All told, CEO Kenneth Lewis came in at $22 million in 2005.)

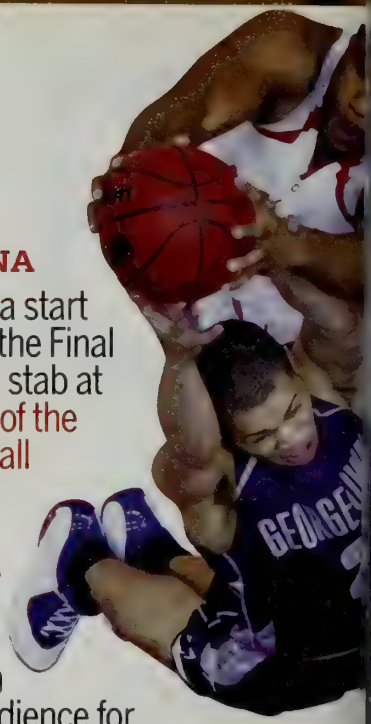
LEWIS

For the first time, BofA lists the dollar value of executives' stock options (page 32) as a pay-package element. And it makes quite a difference. When the current proxy looks back to 2004, it lists Lewis' pay in the new way, for a total of $22.7 million. Compare that with his 2004 pay as disclosed the old, piecemeal way in last year's proxy: $19.2 million, close to 20% lower.

The amount of salary, bonus, and restricted stock, the largest parts of Lewis' pay, are the same in both filings. But the new proxy adds in $3.2 million, the estimated value of the 500,000 shares underlying the options Lewis got in 2004. The older proxy just lists the number of options.

There are also changes in "all other compensation" for Lewis in 2004. The number is $359,223 this year, vs. $195,112 last year. The difference, says Bank of America spokesman Terry Francisco, is primarily due to BofA's now putting a dollar value on its CEO's pension accruals. *–Michelle Leder*

CYBER ARENA



IT WAS QUITE a start on the road to the Final Four. CBS' first stab at free Webcasts of the NCAA basketball tournament drew over 4 million viewers in the games' first weekend. That's a million short of the audience for same-day Webcasts of last summer's Liv charity concerts on AOL Music, but the 200,000 or so who logged on simultanec to view the Madness topped the concerts 175,000 peak audience. At one point befo the first game started, 150,000 fans queu up to log on, according to CBS. A spokesp for Marriott International, whose Courtya chain co-sponsors the Webcasts, said: "V very pleased." *–Timothy J. Mu*

BLOGSPOTTING

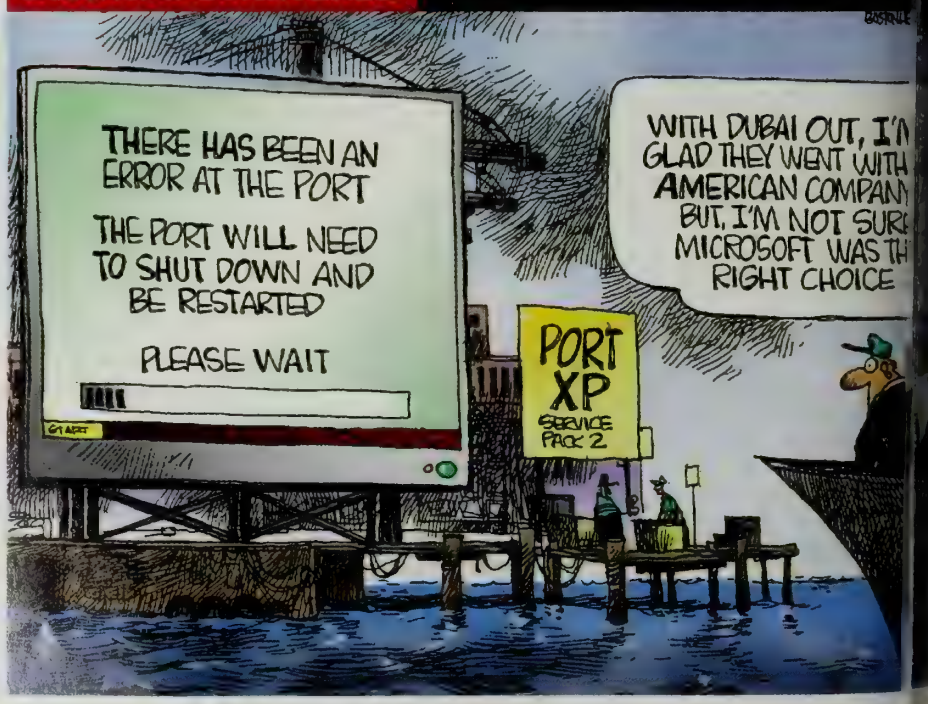
LIFE, THE UNIVERSE, AND ALL THAT

http://scienceblogs.com

» **WHY READ IT** A sister project of *Seed* magazine, this blog aggregator bills itself as the Web's largest conversation about science. Its members include physicists, surgeons, and historians.

» **NOTABLE POST** "...If life doesn't exist on Enceladus [one of Saturn's moons]...I suggest seeding the moon with Terran organisms that might be able to survive and flourish. In a few decades genetic engineering might also progress to a point where exotic...metabolisms could be synthesized with the physiology of more complex aquatic organisms."

DRAWN & QUARTERED



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PROFESSION: PILOT CAREER: ACTOR

ple are acquainted with the star, the multi-faceted actor. But John Travolta is also a seasoned pilot with more than 5,000 flight hours under belt, and is certified on eight different aircraft, including the Boeing 747-400 Jumbo Jet. He nurtures a passion for everything that embodies authentic spirit of aviation. Like Breitling wrist instruments. Founded in 1884, Breitling has shared all the finest hours in aeronautical history. Its chronographs meet the highest standards of precision, sturdiness and functionality, and are all equipped with movements that are chronometer-certified by the COSC (Swiss Official Chronometer Testing Institute). One simply does not become an aviation supplier by chance.

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UP Front

DREAM JEANS

THE PERFECT STORM PANTS?

Always looking for a new twist, the makers of blue jeans may find one in a technology designed to keep denim dry in a downpour. Researchers at Cotton Inc., a textile industry group, have created Storm Denim, a Teflon-like fabric coating that would presumably prevent cold-and-clammy jean syndrome by causing water to bead up and run off. The trade group says that denim treated with the coating still breathes, keeping the wearer comfortable. And the finish—designed for use on fabric that's faded, whiskered, embroidered, or dyed—doesn't change the look or feel of a pair of jeans. The treatment also won't alter manufacturing costs much, the group contends, since the coating comes from readily available chemicals. No indication yet that big players in the $14 billion jeans industry are planning a line of water-resistant jeans.

–Louise Lee

BRAND THIEVES

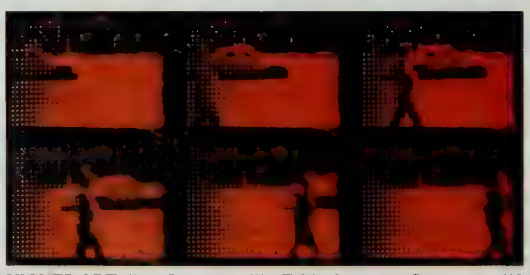
STEALING LOGOS TO PULL SPAM SCAMS

WAL-MART, Home Depot, Starbucks. The names attract millions of shoppers—and those who dwell in the ever-evolving world of computer fraud. Computer security firms are warning about a spate of "brand spam," e-mails promising a "$500 shopping card" at Wal-Mart or a "$500 Home Depot Gift Card." The offers, which use company names and logos without permission, require users to click on a link, type in personal data, and take a survey. Presto! The site says the gift will be mailed.

The offers are, of course, too good to be true. "They are using the brand name to add credibility," says Joel Smith, chief technology officer at **AppRiver,** an e-mail security firm. Smith estimates that of the 500 e-mails per second his firm filters, brand-spam offers account for about 3%. Most have complicated user agreements requiring consumers to take additional steps before getting a gift, such as signing up six others for the promo. It's unlikely, Smith says, that anyone ever receives the gift.

Like phishers trying to steal credit-card numbers, brand spammers are trolling for consumers' e-mail addresses and preferences. The reason? To sell the data to other spammers. Soon after signing up for one of these offers, a user gets spam for obscure lotteries or "fr movie tickets.

Wal-Mart spokesman Martin Heires says the company is warning consumers that it never freebies over the Intern Home Depot says it has worked with law enforc to shutter sites using its Starbucks says it is awa the Starbucks "offer," w is "definitely not a Starb project." *–Brian*



HIGHER ART Jim Campbell's *Fifth Avenue Cutaway #1*

EXHIBITIONISM

WHAT'S THE BEST WAY for litt known artists to boost the valu their work? Exhibit at the Whitn Biennial, where Wall Street collectors are part of the spect Buzz generated by the Biennia which this year runs through M at New York's Whitney Museum of American Art, helps drive up exhibitor prices. Here, according to art dealers, are three examples of artists who benefited, along with the highest price paid for their art before a biennial the best price they got for a piece soon after the opening. *–Reena*

ARTIST	BIENNIAL YEAR	PRE-OPENING HIGH	POST-OPENI
Yuri Masnyj Drawing, sculpture	2006	$6,000	**$18,0**
Jim Campbell Electronic art	2002	12,000	**28,0**
Shahzia Sikander Watercolor paintings	1997	2,400	**5,0**

Data: Metro Pictures Gallery H

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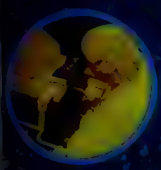

MANUFACTURING:

Singapore's Best Kept SECRET

Belying its physical size, Singapore sports a global reputation as a compelling hub for business and investment, and a competitive manufacturing location of choice. Manufacturing has helped Singapore grow as a nation over the past 40 years.

Today, manufacturing contributes to a quarter of Singapore's economy and accounts for more than half of its exports. Its share of GDP has been trending upwards over the past 10 years.

Manufacturing Culture

Singapore's strong manufacturing culture evolved over four decades. From a labour-intensive economy, it has built on its manpower skills, infrastructure and technology. Today, manufacturing has moved up the value chain, and is complemented by robust supporting industries and a strong services sector.

Enterprise Ecosystem

In one compact location, Singapore's vibrant enterprise ecosystem provides all the resources for companies to fulfil their entire manufacturing value chain of activities – from research and development, to testbedding, design, production, supply chain management, sales and marketing, and headquarter (HQ) services. The concentration of international enterprises, HQs and startups provide the ideal platform for the meeting of global talents, ideas, funds and businesses.

Supply Chain Management

Singapore's integrated supply chain management ecosystem, which spans information technology, financial and managerial expertise, ensures optimized and cost-effective global deliveries. Its wide network of trade and mutual recognition agreements extend our reach to the world, enhancing the seamless flow of goods, funds and talents.

Emerging Areas

As Singapore continues to further develop its industry clusters, it will actively nurture manufacturing in emerging areas, such as nanotechnology, biotechnology, water technology and new materials. These new growth areas are built on a bedrock of existing strengths in multiple industries, such as electronics, chemicals, biomedical sciences and engineering.

Technology

Today, companies can be highly competitive in manufacturing when it is closely integrated with technology development. The scene in Singapore for technology is set with a stringent intellectual property environment, numerous research institutes and increased investments in research. Singapore is indeed fertile ground for R&D and innovation.

With its winning combination of technology, efficiency and reliability, companies such as Motorola and Hewlett-Packard (HP), recognize that Singapore is a cost-competitive location for manufacturing, and have been expanding their operations here. Motorola currently manufactures 60 per cent of its global 3G phones in Singapore, while HP makes its top-of-the-line servers in Singapore.

Discover Singapore's best kept secret - manufacturing. Visit www.sedb.com/edb/bw or contact any of our U.S. offices to find out why choosing Singapore for your manufacturing needs makes all the right sense.

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Singapore's Global Leadership Positions in Manufacturing Today

Position	Product	Market Share
World		
No. 1	Offshore oil rigs	70%
No. 1	Floating Production Storage Offloading (FPSO) conversion	70%
No. 1	Axial auto insertion machines	60%
No. 1	Ship repair services	20%
No. 3	Wafer foundry	10%
No. 3	Oil refining centre	
Asia		
No. 1	Aerospace maintenance, repair and overhaul	
No. 1	Oil field equipment manufacturing and services	
No. 1	Flavors and fragrances	
No. 1	Lube additives	

ReadersReport

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> "A permanent tax on gasoline consumption... [could] reduce net money flows to our...enemies."
>
> *–David Tolwinski*
> *Newport, R.I.*

A GUSHER OF RESPONSES TO A MIDEAST AWASH IN PROFITS

RE "THE NEW Middle East oil bonanza" (Cover Story, Mar. 13): Rather than place a permanent tax on gasoline consumption, which would allow a greater portion of these revenues to remain at home to fund domestic programs, develop alternative energy sources, and reduce net money flows to our geopolitical enemies, America's political and business leadership allow a tax, in effect, to be imposed externally for the benefit of others!

–David Tolwinski
Newport, R.I.

IF JUST 1% OF estimated 2006 gross oil revenues of $380 billion finds its way into radical Islamic schools, mosques, and in support of *jihadi* terrorists, it would be a most unfortunate payback for fueling hydrocarbon-driven Western and developing economies. It would be better for these ruler states to alleviate the poverty of their young people so these economies can be modernized, living standards raised, and women and children freed from suppression and incitement to hate.

–Jerome B. Gordon
Fairfield, Conn.

IN "DON'T UNDERESTIMATE the f[illegible]tor" (Cover Story, Mar. 13), Peter C[illegible] experts who peg $15 to $30 of oil p[illegible] "fear." Oil prices, over anything oth[illegible] the very short term (days or weeks[illegible] function of supply and demand. Sin[illegible] difficult to hoard and because [illegible] drives their car more in anticipatio[illegible]ture supply interruptions, fear h[illegible]ginal impact on demand. On th[illegible] hand, speculative short-term price [illegible] caused by supply fear are sustaine[illegible] supply interruptions materialize. [illegible] actual supply, not the fear of losin[illegible] drives oil prices higher.

–Ma[illegible]
Terrace Pa[illegible]

IS IT MY IMAGINATION or is th[illegible] page spread of Dubai completely d[illegible] people? What does the "real" Du[illegible] like? Or am I looking at a scale m[illegible]

–[illegible]
Boca Ra[illegible]

Editor's note: It's the real Dubai. [illegible]

ANTI-AGING MEDICINE: WHAT *BUSINESSWEEK* LEFT O[illegible]

I WOULD LIKE TO clarify some i[illegible]cies in "Selling the promise of [illegible]

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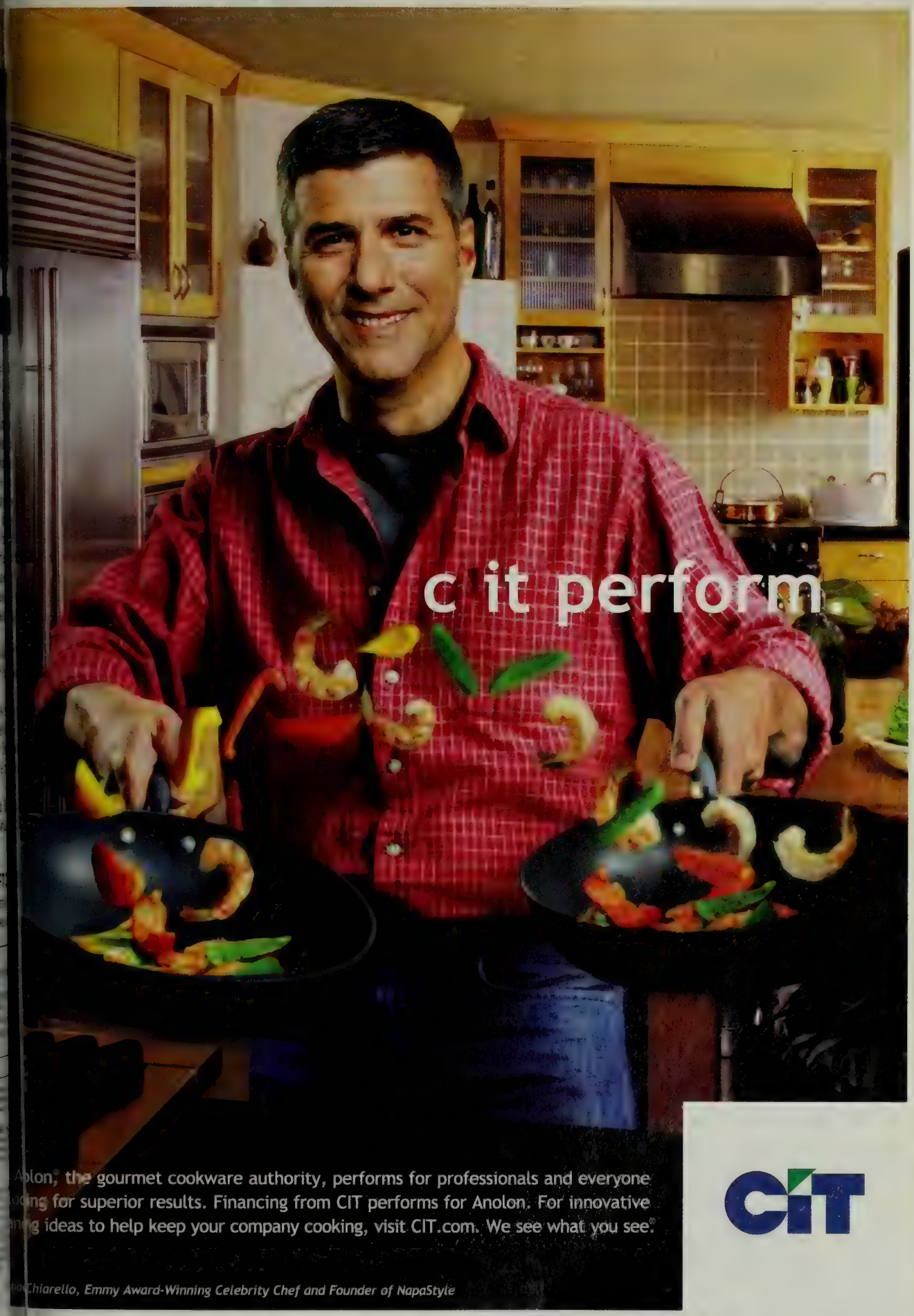
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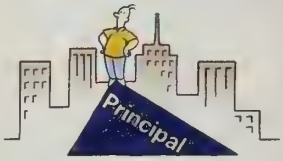

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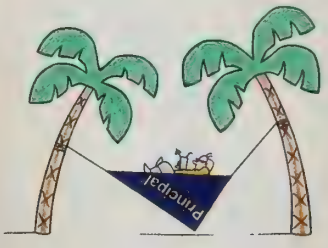

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ReadersReport

(Cover Story, Mar. 20). When I introduce the field of anti-aging medicine to patients, I never "pitch" anything or tell them that they will feel younger or live longer. I ask patients what they would like to accomplish, what their concerns are, and provide information on anti-aging and preventive medicine approaches. If patients wish to pursue this route, I plan safe programs for them.

Your article does not reflect a statement I made to *BusinessWeek* that 80% of anti-aging medicine is lifestyle, virtually free of cost, and work that you have to do yourself: nutrition, exercise, and stress reduction, supplemented with vitamins, antioxidants, and neutraceuticals. If hormone replacement is medically indicated to treat a deficiency disease that happens in aging, bio-identical hormones are replaced scientifically and carefully based on diagnostic testing. Bio-identical hormone replacement is the "icing on the cake," not the foundation of anti-aging medicine.

Let me also clarify my statements on growth hormone replacement therapy to treat adult growth hormone deficiency. While you quote me as saying that "growth hormone is no worse than any drug that can be prescribed off-label," I emphatically stated in my interview and in my seminar that this hormone can only be used for an on-label indication.

Your comments regarding medicines produced by compounding pharmacies are also inaccurate. Compounding pharmacies produce medicines derived from Food & Drug Administration-approved drugs.

The goal of anti-aging medicine is simply to keep us as healthy and happy as possible for as long as possible. It is a work in progress.

–Ron Rothenberg, M.D., Founder
California HealthSpan Institute
Encinitas, Calif.

SUPERFUND SKEPTICS SEE OUTSIZE RISKS AND IFFY RETURNS

"WELCOME TO SUPERFUND" (Special Report, Mar. 6) correctly alerted readers to to look at risk. Is some or all of the added return a result of added risk (and how much), and what is the "risk-adjusted" return compared with other investments?

BusinessWeek shows the performance for one of Christian Baha's funds for approximately 12 years. Such a period is often too small to confirm that above-average returns are not due to general luck or to the specific luck of using strategies that happened to work in the given 12 years but that may not work well in other periods.

–Jacob Sacolick
Cornelius, N.C.

CORRECTIONS & CLARIFICATION

In "Time off" (Personal Business, Mar. 1 we mistakenly said *American Gothic* w not be part of the Grant Wood exhibitio running through July 16 at the Smithso American Art Museum. The painting, o loan from the Art Institute of Chicago, w be in Washington through June 11.

"Filtering out the madness before a tra fusion" (Developments to Watch, Mar. mad cow disease should have clarified Pall Corp.'s device for filtering prions fr blood is already available in Europe.

In "The struggle to measure performar (News: Analysis & Commentary, Jan. 9 source line in the table "Performance A attributing some of the content to Hew Associates was inadvertently omitted.

LET'S SEE WHAT we have here, a concept: a virtual mutual fund for unsophisticated investors that them to play the way the big boys other words, with secretive, risky i ments for people who don't unde them and can least afford the highe It seems to me that the reason the S ties & Exchange Commission u frowns on this is to protect the pub to keep them from making money.

In your story, Baha says the "sup are used to going long and short," w not accurate. The super-sophis hedge by going short in addition t but most people with extensive ass mainly concerned with holding on t money by using simple, safe techni like buy and hold.

–Ronald E
Plaatsdale Investment Advis
Branford

How to reach BusinessWee

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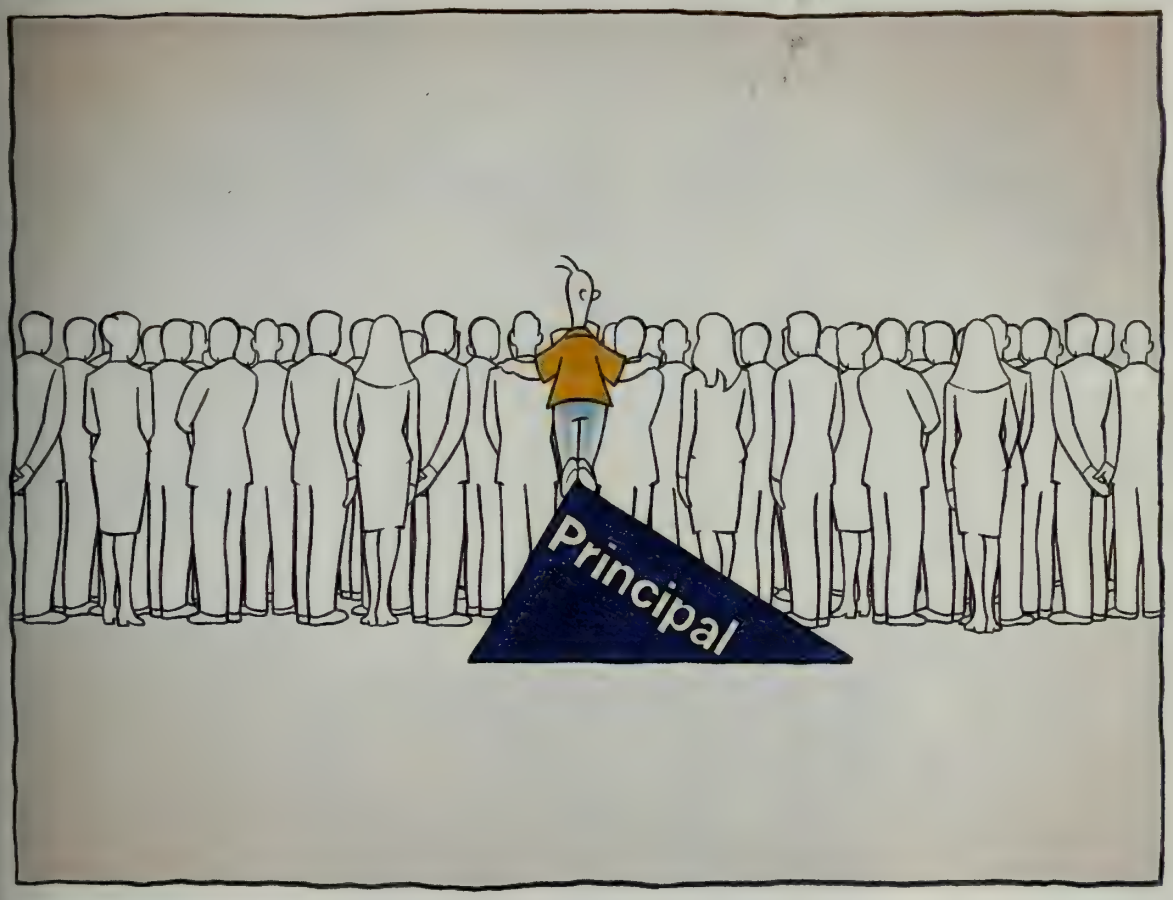

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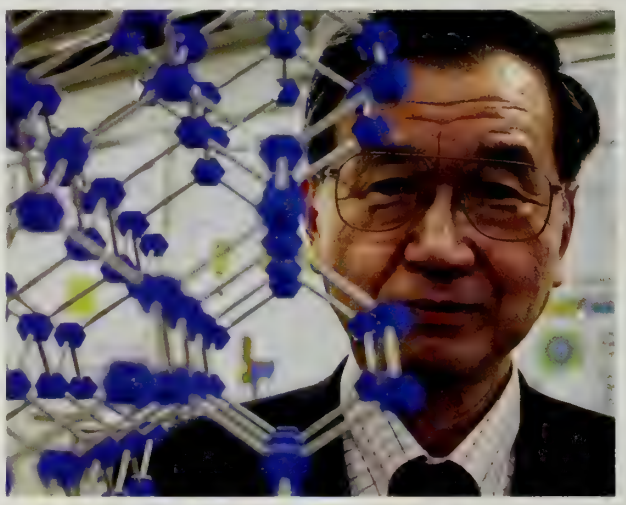
Thanks for the Memory

FLASH MEMORY CHIPS, which store data in cell phones, digital cameras, and music players, didn't exactly arrive in a flash. They were invented more than two decades ago by Fujio Masuoka, a midlevel factory manager at Toshiba. He was supposed to be working on chips called DRAMs (for dynamic random-access memory), which became the workhorses of the personal-computer revolution. But such semiconductors retain data only when the computer is switched on. That wasn't good enough for Masuoka. His heart was set on memory chips that would preserve the user's data whether the power was on or off, thus eliminating the need for fragile hard-disk drives.

Few engineers had faith in Masuoka's ideas at the time. But the intervening years have provided sweet vindication to the circuit designer, who is now 62 and a professor at Tohoku University in the northern Japanese city of Sendai. Global demand for flash memory is poised to hit $25 billion this year, according to research from CLSA Asia-Pacific Markets, thanks mostly to fast-proliferating handheld gadgets. And on Mar. 21, Samsung Electronics unveiled the world's first 32-gigabyte drive built entirely of flash. This drive should lead to a new breed of futuristic—albeit expensive—notebooks. They'll be shock-resistant; they should boot up in seconds rather than minutes; and they could stay powered-up 50% longer than other notebook PCs between battery charges.



The flash chips Masuoka developed now store data for all sorts of electronics

Nobody anticipated such a development in the early 1980s, when Masuoka began bucking conventional wisdom on data storage. "Simply put, I wanted to make a chip that could one day replace all other memory technologies on the market," he explains. To pull it off, Masuoka drew four other engineers into an ad hoc team and came up with a blueprint. In 1981 he filed a patent for EEPROM—short for electrically erasable programmable read-only memory. One of Masuoka's colleagues simplified that to flash memory, because the transistors' ability to erase data in a split second reminde him of a camera flash.

Despite Samsung's recent announcement, many indus experts continue to question the long-term implications Masuoka's invention. "If you're talking about servers or desktop PCs, flash memory will never replace hard-disk drives," says Nam Hyung Kim, an analyst at market rese firm iSuppli. "Hard drives are 100 times cheaper."

Price, however, depends on volume, and production flash memory is poised for historic growth spurt. Inte world's biggest chipmaker an early proponent of one of flash, has inked a $2.4 b joint venture with Micron Technology to produce su chips for consumer produ and for PCs.

Toshiba, meanwhile, rar the world's second-largest memory maker, after Sams Masuoka says he is glad th company is profiting from brainchild, but their relatio have been strained for ma years. In the '80s, Toshiba slow to realize that it was s on a breakthrough, Masuo says. The truth didn't sink in until Masuoka made a presentation at an international chip conference in San Calif., in 1984. Four years later, Intel came up with a competing version that was easier to manufacture.

Intel's move finally galvanized Toshiba, and Masuok promoted to head one of its advanced research labs. Bu bluntness made him enemies in a culture where compr and consensus are prized. Masuoka left Toshiba in 199 after a run-in with his boss got him transferred to a pos without staff or funds. In 2004 he sued the company fo he considered his rightful cut of its profits on flash: abo million. The case is pending in a Tokyo court.

Masuoka now predicts that current versions of flas reach their technological limits in a few years. But he vinced that some type of low-cost, 3D chip will eventuall disk-drive makers out of business. There will always be er barrier, he concedes, but "someone will come up breakthrough technology to get around it." ■

–By Ke

BusinessWeek online Fujio Masuoka discusses the early days memory in a Q&A at www.businessweek.com/extras

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BY STEPHEN H. WILDSTROM

Total Wi-Fi Freedom

Now that nearly every new laptop comes equipped with Wi-Fi, it seems y should be able to plunk your computer down just about anywhere, log o to a wireless network, and get to work. Alas, it's not that simple, because Wi-Fi is neither ubiquitous nor always cheap. That's why new PCs that u both very fast cell-phone networks and Wi-Fi are attractive.

These wireless services provide a broadband-like experience, with download speeds consistently topping 500 megabits per second. There are three competing offerings: Verizon Wireless BroadbandAccess, Sprint Mobile Broadband, and Cingular BroadBand Connect. A couple of years ago PC makers started providing access to such services with add-on cards. Now they're building the access right into the laptop, which is much more convenient for the user.

I tried Verizon's service on a Lenovo ThinkPad T60 and Cingular's service on Dell's forthcoming Latitude D620, both corporate workhorse notebooks. With these cell-based systems, the laptop is tied to a carrier. All manufacturers are planning to offer versions for different carriers, in the U.S. and elsewhere, but changing carriers may require that a technician yank out one radio and install another. Even if that's unnecessary, to get a decent rate you have to lock yourself into a two-year contract.

While Cingular uses a different technology than Verizon and Sprint, I found all the services comparable. But there are differences in coverage. Verizon's high-speed network is the oldest, and it's available in most major metropolitan areas. Sprint's is spottier, and Cingular is in just 16 metro areas. In each case there's backup service at dial-up speeds if the fast network is not available, but it's a painful step down.

FOR NOW, AT LEAST, VERIZON is probably the best choice in the U.S. It offers unlimited data service for $60 a month on a two-year contract, provided you also have a Verizon phone with a voice plan. If you don't have a laptop with built-in wireless, they'll sell you a PC Card radio for just $50. Sprint offers a similar deal with a free card—which you'll need since no laptops are currently sold with built-in Sprint service.

Cingular may be the best deal for the globally mobile. Unlimited U.S. service costs $80 a month (now available for $60 as a "limited time" offer) for customers with a Cingular voice plan. Its technology is compatible with the high-speed networks being rolled out in Europe and Asia. Cingular offers a $139-a-month plan that provides unlimited data in the U.S. plus 100 megabytes in monthly downloads in more than a dozen countries. If that sounds expensive, you probably have ne gotten a bill for international dat roaming. Cingular also offers acc to several thousand Wi-Fi hotsp for an additional $20 a month.

That last deal highlights the f that phone-based wireless servic should be seen as a complement Wi-Fi rather than an alternative. Unlike Wi-Fi, these services can used throughout the coverage an not just in hotspots. You can con simply by clicking, as oppo to registering separately fo hotspot. And the service w in moving trains and cars (while you're driving, pleas the other hand, regular Wi generally faster, especially data uploads, such as posti your vacation pictures to a site. And Wi-Fi often perfo better than cellular inside buildings.

Cell-based services for PCs connect with a click and work in moving trains

Laptop makers should b doing a better job of gettin Fi and cell-based wireless to work together. Lenovo at lea you manage both using its Access Connections software, you still have to change profiles to switch. Ideally your computer would simply connect you to the best available network without any intervention.

For people who connect away from home or the office occasionally, these cell-based services are probably not w the extra cash. But for a road warrior the ability to conne anywhere, anytime, will more than justify the cost. ■

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Designs on the Disaffected

Procrastination 2.0: The business model. Don't laugh. It's driving Time Inc.'s newest and strangest launch, the Web site Office Pirates, a big-lea play for a kind of disaffected young man who's glued to his office computer. ¶ This guy is a pop-culture freak who gravitates toward "crash explosions, girls, craziness, obscenity, blah blah blah," says Simon Assaac

CEO of heavy.com. (Heavy.com, which features short videos ranging from scabrous cartoons to swimsuit fashion shoots, has a channel entitled Crashes and Explosions.) He spends hours trolling sites like Viacom's iFilm.com, which lets users post and view video clips. When he finds something there he likes—say, *Star Trek*'s William Shatner murdering Elton John's *Rocket Man*—he sends a link to his friends.

SO RADICAL, SORT OF Can Office Pirates' videos (below) make a splash like the goofball rap video *Lazy Sunday* (left)?

Guys like him made Andy Samberg a star. Samberg became a new "featured player" on *Saturday Night Live* this season, which roughly translates as "glorified benchwarmer." Then he co-conceived and co-starred in a short, spectacularly entertaining rap video, *Lazy Sunday*. Within hours of airing last Dec. 17, it hit sites like iFilm and youtube.com and became an immediate "viral video" hit. Within weeks the video had been played more than 5 million times on youtube alone, and Samberg appeared on David Letterman and Conan O'Brien.

VIRAL VIDEOS ONCE were, you know, videos—blips of bizarreness copied and traded on VHS tapes. The Web destroyed this distribution bottleneck. That destruction enabled Samberg's fame, and it's why Time Inc. launched Office Pirates. Office Pirates is atypical for Time—launched quietly, promoted sparingly. It has but five full-time staffers. It hit the Web on Feb. 22 with exactly two advertisers, Bacardi and Dodge Caliber. No more have signed on since. It is very off-brand for the world's largest magazine publisher, which has never before targeted the ever-feel-like-killing-your-boss crowd. One short video shows a customer-service rep seated in front of a thought-bubble graffito pleading "Kill me," and another features a postcollegiate type itching to shoot his clueless boss. There are mock motivational posters and links to weird Web sites, and users can submit t own content.

It's deeply perverse (in th way) and looks good on pap fusing favored Web modes moment: communities, use created content, and eagerly shared form video. The idea is that elusive y men will flock to the site and turboc via their own programming and wor mouth. Low-cost means quick profit fast exit. And some big-name advert sweating over disintegrating ad mo are receptive to such nascent media formats. Young men "feed like shark ribald, short-form online content, sa Dodge marketing executive Mark Sp "We are there because they are there."

It's admirable for Time Inc. to try something this biza it's a drag that Office Pirates seems very version-1.0. The programming is wildly inconsistent. What's perverse for Inc. is not perverse for the Web, and so it lies between fr form sharing sites like youtube and gnarlier programmi plays such as heavy.com (which is also readying a comm platform). Office Pirates plasters its offerings with its na logo. But for such content to work, "it's got to be organic be emanating from something that doesn't appear to be commercialized," warns Laura Desmond, CEO of media firm MediaVest USA.

Lazy Sunday took off organically. But when Samberg another SNL video in March, starring Natalie Portman foul-mouthed gangsta rapper, it made a much smaller cultural splash. Office Pirates' "plan does not bank on idea of becoming a serial creator of these outrageously serendipitous viral events," counters Time Inc. Interac President Ned Desmond. Fair enough. But there's one about programming for procrastinators: If they don't s what they want on Office Pirates, they have all the time world to find it elsewhere. ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

IAMES C. COOPER

This Porridge Still Looks A Little Too Warm

ong demand at home and abroad is heating things up at U.S. factories

U.S. ECONOMY Goldilocks lives. The economic scenario, that is. ose who believe in her think the economy this year will be not too , not too cold, but just right. Currently, it's the view most widely d by economists, investors, and Wall Street pros. So, the tale goes, r the unusually warm winter heated up the economy in the first er, growth will cool down to a pace of about 3% that lieve any remaining worries about future inflation terest rate hikes by the Federal Reserve. If so, stock will most likely extend this year's rally, and bonds enefit as well.

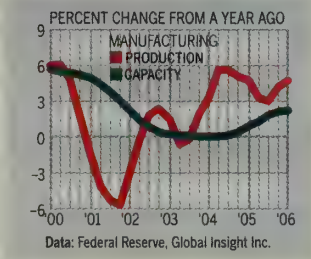
will it really be that simple? Much will depend on t perceptions of how the economy is shaping up in cond quarter. And on that front, the recent pace of vement in the manufacturing sector will be a key pment to watch. Some regional survey results for activity in March have looked surprisingly upbeat, sting that manufacturing is ending the first quarter good bit of momentum. That could be an ant sign. The industrial sector began gathering late last year, and historically when manufacturing mph, so does the overall economy.

factory sector's thrust also reflects a key pattern driving economic growth this year. That is, the roles played by capital spending and exports, are two important engines of factory activity. h January, inflation-adjusted exports of goods are from a year ago, and exports of capital goods are . Through February, production of business ent has grown 10%, with output in the high-tech p nearly 22%. Those growth rates are sharp ations from this time last year.

st factory activity also may be a sign that overall d is not cooling. If so, the ability of manufacturers up will continue to be stretched. Output is already ping the growth of new production capacity That's pushing up operating rates and giving ies more leeway to lift prices, a pattern the Fed is a keen eye on. The dollar's surprising strength r helped keep the prices of goods down, but that t be the case in the coming year (page 28).

THE WEATHER ALSO RUNNING hot and cold in quarter, making sense of the economic numbers n more than the usual challenge. According to the test report on industrial production, cturing output jumped 0.8% during balmy , but it managed only a scant 0.1% advance in y as normal temperatures returned. The true strength is probably somewhere in the middle. Monthly gains averaged a sturdy 0.6% during the past six months. Anecdotal reports of factory activity are unambiguously upbeat. The Federal Reserve's latest roundup of economic conditions in all 12 Fed districts, prepared in advance of the Fed's Mar. 28 policy meeting, showed that manufacturing activity in almost all districts continued to expand during January and February. And in most districts, Fed banks reported that the strong demand was widespread across industries, especially in construction materials, electrical equipment, heavy machinery, defense products, tractor trailers, and heavy trucks. The concentration of strength in those industries clearly illustrates how demand for capital goods is driving factory production. [For a view on why manufacturing job growth remains weak, see page 136.]

OUTPUT GROWTH IS OUTSTRIPPING CAPACITY



Data: Federal Reserve, Global Insight Inc.

THAT HEALTHY TREND appears to have continued in March, based on upbeat readings from separate surveys of industrial activity taken by both the New York Federal Reserve Bank and the Philadelphia Fed. Both canvasses showed particularly impressive readings for new orders.

Many businesses are running to catch up with demand, a key reason to expect that manufacturing will keep humming along in the coming months. For example, the ratio of business inventories to sales, a measure of the adequacy of current stock levels, fell sharply in December and January. Even accounting for the downtrend in this ratio in recent years, caused by generally lower holdings of inventories by businesses and the faster rates at which stocks turn over, inventories relative to sales are still well below the typical levels seen since the recession ended four years ago.

Much of the demand flowing to manufacturers is for business equipment, and it's coming from both home and

abroad, as growth overseas begins to show more pizzazz. Based on high readings for corporate optimism and plenty of cash to invest, U.S. businesses are set to boost their capital spending in 2006 even faster than last year's 8.7% increase. Numbers on orders and shipments in recent months suggest that outlays for new equipment got off to a booming start in the first quarter.

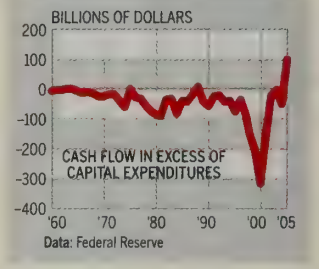
The most striking evidence of U.S. corporate health shows up in recent data on business-sector balance sheets. Through the fourth quarter of last year, the internal funds available to nonfinancial corporations for investment had exceeded the level of capital expenditures for three quarters in a row. Companies have never before shown that degree of financial flexibility (chart).

ALTHOUGH COMPANIES have been hesitant to expand after the investment bust five years ago, two things are happening right now that are affecting both manufacturing and the economy. One, businesses are rushing to expand their operations in the face of strong demand and insufficient production capacity. And two, because factory output is growing more than twice as fast as new capacity is being added, manufacturing operating rates have risen sharply during the past year.

Through February, factory output in the first quarter was up 4.8% from last year, while capacity grew only 2.3%. Consider that five years ago manufacturers were increasing their capacity at more than twice that rate. In February, factories were using 80.1% of their capacity, a level high enough to suggest that some manufacturers are starting to strain to meet demand. Seven indust February, representing 18% of factory output, were operating in excess of 85% of capacity.

Ultimately, it will be up to the Fed to decide if the economy is cooling down enough to stop raising int rates. Right now, though, the Fed appears to be as n in the dark as anyo about how the econ is shaping up. On M 20, Fed Chairman B Bernanke gave Wal Streeters in New Yo impressive analysis why long-term inte rates were unusuall given the Fed's seri short-term rates hik His conclusion: He know why. He said might be too stimul requiring further hikes in short rates, or they might justified by global conditions, perhaps requiring lov short rates. It was an exercise in being noncommitt worthy of Alan Greenspan.

COMPANIES HAVE GREAT FINANCIAL FLEXIBILITY



Data: Federal Reserve

The only way to know for sure, he said, is to wato economy and the data. Of course, investors and economists already knew that. In the coming month they will be checking the temperature of the porrid as intently as the Fed. But based on the heat coming manufacturing, it still looks a little on the warm sid

INFLATION

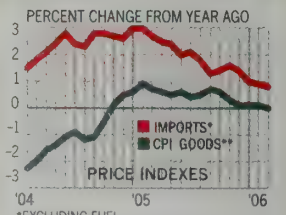
The Greenback's Gain Isn't Likely to Last

FEBRUARY CONSUMER and producer price data paint a seemingly benign outlook for price pressures. One key ingredient in the recent easing in inflation was the surprising uptick in the U.S. dollar last year. But the underpinnings for the stronger dollar are set to fade.

During 2005, the U.S. dollar defied economists' expectations and rallied. The Federal Reserve's trade-weighted index of major currencies rose 8.4% in 2005 with most of the gain coming in the first half of the year. The gains were even larger vs. the yen and euro, with 14.8% and 8.7% jumps, respectively.

The upshot is that "the rise in the dollar against these currencies appears to be translating directly into softer import prices from these regions," says Barclays Capital chief U.S. economist Dean Maki. The yearly overall pace of nonfuel import prices has eased to 0.8%, from 2.7% last February. The slowdown has been even bigger for all goods from the European Union, receding to a pace of 2.9%, from 6.3% last February. Prices of Japanese imports fell 0.9% in the past year.

HOW IMPORTS HAVE RESTRAINED INFLATION



*EXCLUDING FUEL
**LESS FOOD AND ENERGY GOODS
Data: Bureau of Labor Statistics, Global Insight Inc.

During the same period, consumer goods prices excluding food and energy were flat. That has helped pull down overall core inflation in the face of accelerating service-sector prices, which are now up 2.9%.

However, the relief from last year's higher greenback is unlikely to last. Th Federal Reserve has lifted its fe funds rate 350 basis points sinc June, 2004. The Fed hikes push U.S. short-term rates past those euro zone and widened the gap against Japan's rates of near 0% result was an influx of foreign n which helped push up the dolla

Many economists expect the take a break by midyear. At the time, the European Central Bar sounding more hawkish, and th Bank of Japan is ending its ultr accommodative experiment of quantitative easing.

What's more, global econom activity is expected to accelerat year even as the U.S. economy s into a more modest rate of grov a result, demand for the U.S. dc should begin to wane, eliminat inflation-dampening effects of l import prices. ■

–By James Mehring in Ne

VANT TO DO USINESS WITH ITALY? VE CAN GIVE OU A HAND.

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The Business Week

News you need to know

EDITED BY HARRY MAURER

GM in the Garage March may not have been the cruelest month for General Motors, but it's up there. The dented auto maker (Detroit headquarters, photo) on Mar. 16 restated 2005 earnings to the tune of $2 billion in red ink, which means it lost $10.7 billion. About $1.6 billion of that has to do with costs to bail out its former parts unit, **Delphi,** and give buyouts to some of its own workers. The rest stems from rejiggered earnings at its finance arm, **GMAC.** Couple the gargantuan loss with aggressive noises coming from new board member **Jerome York,** and it's clear that **CEO Richard Wagoner's** driver's seat is mighty hot.

At least Wagoner has a pact with the **United Auto Workers** to help retool. GM said on Mar. 22 that it has agreed to a deal that will retire as many as 30,000 of its workers and more than 10,000 at Delphi. That could speed up plans to hutter or cut production at a dozen plants.

See "A Gleam of Hope for GM," www.businessweek.com/go/tbw

Bernanke-Speak "On the one hand, on the other" is the economist's stock-in-trade, as **Harry Truman** noted when he demanded a "one-handed economist." **Fed Chairman Ben Bernanke** didn't disappoint the two-handed gang in a Mar. 20 speech. Addressing puzzlingly low long-term U.S. interest rates, Bernanke came to no conclusion on whether the Fed needs to tighten or loosen in response. But he did explain the low rates as the gift of a global savings glut.

See "What you foresee is what you get," page 40

Red Faces in Redmond This is starting to resemble *ing for Godot.* **Microsoft** on Mar. 21 revealed that the releas much-delayed new operating system, **Windows Vista,** wo bumped back yet again, from November until January, consumer version. The move ultimately may not hurt sales but it sure makes the Redmond (Wash.) giant look clums

See "Microsoft's slo-mo scramble," page 3
"Microsoft's receding vista," www.businessweek.com/

So Long, Sandy **Citigroup** made it official on M **CEO Charles Prince** will add the post of chairman at t nual meeting on Apr. 18 as billionaire dealmeister **S Weill** steps down. Weill was chairman at Citi and pre sor companies for nearly 20 years. Under Weill, Citi predecessor ranked No. 1 in total shareholder return Dow 30 for the 10- and 15-year periods ended D 2005. Over to you, Chuck.

See "For Citi, 'No more excuses,'" pa

Searching for Money **Google** built its fortune by ing surfers elsewhere. But these days it's trying t folks glued to its sites, giving it more chances to se On Mar. 21 it unveiled Google Finance, a searchab packed with news, charts, company profiles, and quotes. That moves Google into a dog-eat-dog aren everyone from **Yahoo!** to **Microsoft's MSN** to **Dow Jones ketWatch** drawing tens of millions of users. The searc hopes to win with gee-whiz features such as histori charts that can be dragged with a click of a mouse.

See "Google shows surfers the m
www.businessweek.com/

Quattrone Beats the Rap Criminality is a state of That's the message from a federal appeals court, wh Mar. 20 tossed out the obstruction of justice convic **Frank Quattrone,** a once high-flying investment b Prosecutors charged Quattrone for telling colleague e-mail to "clean up" files at a time when the **Justic** was investigating his firm, then known as **Credit Suis Boston.** The appeals panel said the judge's instru wrongly allowed jurors to convict Quattrone even if n't know his e-mail would affect the probe. No know no crime, the court said. Prosecutors are pon whether to retry the case.

The Justices Plug a Loophole When was the la a company racked up a win in a shareholder lawsu Mar. 21, when a unanimous **Supreme Court** banish vestor class actions from state courts. *Merrill Lynch* v centered on a 1998 reform that sought to rein in shar er suits by pushing claims related to "the purchase c of stock into federal court. In 2002 a broker sued M Oklahoma, claiming that the firm misled him and into holding on to overvalued shares. Because there buying or selling, the broker said, the case could be h a state court. The high court skewered that notion. I ers in the case: savvy lawyers seeking to have claim by sympathetic state judges.

an's New Mobile Player In one fell swoop, Inter-ycoon **Masayoshi Son** became a cell-phone heavy-ht. Son's **Softbank** on Mar. 17 ponied up $15.5 billion y **Vodafone's** Japanese mobile unit. The deal, one of the st ever in Japan, gives Softbank 15.1 million cus-rs and a nationwide cellular network to add to its olio of Net, broadband, and fixed-line services. It also es Vodafone executives of the headache of fixing a ess with shrinking profits.

See "Softbank-Vodafone deal rings true," www.businessweek.com/go/tbw

rers on the Prowl Merger mania is shaking up the world of insurance. Deal-hungry **Aviva,** Britain's t life insurer, on Mar. 16 aimed a nearly $30 billion t crosstown British outfit **Prudential PLC,** which ged it off. The next day, *The Wall Street Journal* re-d that **St. Paul Travelers,** of St. Paul, Minn., is talking urich Financial Services of Switzerland about teaming St. Paul denied it.) Meanwhile, **MetLife** is sniffing d the world for deals. Such combos could give **AIG,** a iant with major overseas operations, more muscular to fret about.

w Move for Dell For the first time ever, **Dell** is buy-other PC maker—and moving upscale in the process. r. 22 the maker of plain-Jane computers said it plans ire Miami-based **Alienware,** a privately held purveyor -end machines favored by gameheads and other af-types. Terms weren't disclosed. Dell is searching for o revive sales growth, projecting it will reach 6% to s quarter, far below the 16% posted only a year ago. are boxes average $3,200, far more than Dell's.

Exit of the Week

e **GE** of sports leagues, but its **Jack Welch** is about to the game. On Mar. 20, **Paul Tagliabue** said he would lown in July after quarterbacking the **NFL** for the 6 years and turning it into a money machine that's nvy of every sports operation. So who'll fill his ? Tagliabue's longtime No. 2 is **Roger Goodell,** and the job is essentially his to lose, say sports industry sources. The 47-year-old Goodell, son of former **Senator Charles Goodell** (D-N.Y.), has spent nearly his entire career at the NFL, playing major roles in negotiating TV and labor deals. Also on the depth chart is **Rich McKay,** 47, president of the **Atlanta Falcons** on of legendary **University of Southern California** and **Bay Bucs Coach John McKay,** who serves on the 's powerful competition committee. A longer **Eric Grubman,** 48, ex-**Goldman Sachs** banker who years has headed up finance and strategic trans-s at the NFL. And two Hail Mary contenders: **Bill** and **Condi Rice.**

AGLIABUE

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COMPENSATION

THE BOTTOM LINE ON OPTIONS

Who are the winners in the battle over expensing? Just look in the corner office

BY MARK GIMEIN

MORE THAN ONE WAR has been fought over the fine points of religious dogma, and the narrowest differences in ideology have caused some of the bloodiest conflicts. These are the wars that sweep away everything in their path while the participants forget the reason they started fighting in the first place.

So it is—minus the blood—with the Great Options Battle. You will recall how it started, with Warren Buffett leading the charge on one side, Intel Corp.'s Andy Grove and Cisco Systems Inc.'s John Chambers waving their pennants on the other, all battling over accounting rules. Lifted on a tide of anger over ever-more-outsize executive pay packages, the corporate-governance party prevailed. Now the new rules that require U.S. companies to count stock options as an expense are in effect for nearly everyone. But it turns out CEOs might well lose little or nothing. If anyone is taking a hit, it is the professionals, engineers, and managers who hoped they too could cash in on the options boom.

Stock options became popular in the 1990s as a tool that was supposed to "align the interests" of shareholders and management—in other words, reward CEOs for concentrating on raising their stock price. Silicon Valley, of course, seized on options as a way of attracting top engineering talent. Finally, at the height of the market boom, big companies that wanted to project an image of rapid growth and general with-it-ness started giving out options to thousands of their employees. Aetna, when it shed most of its old insurance businesses, instituted an option plan for all employees. So did Time Warner when it merged with America Online. The total number of U.S. employees who got stock options grew to roughly 10 million at the height of the options boom in 2002, according to a study by the National Center for Employee Ownership (NCEO), a think tank in Oakland, Calif.

Now the center's director, Corey Rosen, estimates the number is dov million and shrinking. Before the n counting rules kicked in, options w visible on the corporate income ment. No matter how many a co handed out, they could tell investo they cost nothing. Not anymore. C hugely generous with employee c through last year, when almost $4 lion worth were handed out, this y switched to giving out restricted which vests over time. But Googl pansive stock program is the exc Aetna, whose employees profited somely as its shares ran up in t years or so that it gave options, la replaced them for non-manager $500 bonus checks.

"OUTLANDISH PAY"

FOR TOP EXECS who no longer option grants, the make-good m far more handsome. Merrill Lync last gave CEO E. Stanley O'Neal in 2003. Over the past two years placed his cash and options packa

IN THIS SECTION:

Microsoft's struggles in a Net-speed world **38**

Governance activist ISS is shifting priorities **40**

For the Fed, inflation expectations are key **42**

Al Jazeera hits roadblocks in the U.S.

BRING 'EM ON Ellison's grants rose last year

The **Options** Squeeze

As companies have moved toward reporting stock options as an expense, many cut back on the popular perk. But a few CEOs saw an increase in grants last year.

COMPANY	2005 COMPANYWIDE SHARES GRANTED (% DECREASE VS. 2004)	CEO'S TOTAL SHARES GRANTED (% INCREASE VS. 2004)
FEDEX	2.6 million (-31%)	Frederick Smith 325,000 (+30%)
ORACLE	42.7 million (-0.3%)	Larry Ellison 2.5 million (+177%)
SPRINT-NEXTEL	7.1 million (-8%)	Gary Forsee 885,000 (+13.5%)

Figures for companywide option grants are calculated using data on CEO option grants disclosed in company proxies
Data: Securities and Exchange Commission filings for 2004 and 2005.

restricted stock grants of—take a deep breath and feel free to whistle—$51 million. A spokesman says O'Neal's compensation reflects the company's performance. Merrill Lynch is an extreme. But just as most big companies have cut options in some way, it's hard to find a CEO whose options weren't or won't be replaced by some other compensation.

Again, look at Aetna. It cut its broad-based option plan in 2004, anticipating the new rules, but continued giving options to top executives through last year. Starting this year, executives, including CEO John W. Rowe, will no longer get options—but they will get substantial grants of restricted stock. And in a few cases the cutting back on options simply stops at the CEO's desk. FedEx's Fred Smith, for example, went from 250,000 options in 2004 to 325,000 options last year, even as the option pool for the whole company was cut by more than 30%. The impetus for the war on options, pay expert Rosen dryly notes, was "outlandish pay packages, but the pay packages are still outlandish."

It's not all gloom for the middle tier. Some in the tech industry predicted that the new expense regime would be the end of Silicon Valley's famous options culture. Not so. Network-hardware maker Cisco, in fact, continues to hand out options at roughly the rate it did before the new changes took effect. Pfizer, an old-line drugmaker whose options plan for managers turned out to be a less than terrific deal, with its stock languishing since the mid-'90s, has cut option grants by 42% companywide. But it replaced the options with shares of restricted stock.

The brand-new startups, meanwhile, have been affected a lot less by options expensing rules than by a host of other regulatory burdens. New companies, whose options are a big gamble, continue to hand them out to lure programmers. The problems created by the requirement to estimate the value of their shares, whic not yet publi manageable. [complying Sarbanes-Oxl 9 on a scale c says Paul Mat a partner at ture-capital USVP, the ne tion accou rules are a " fact, Matteuc that new and noticed rules valuing pri held stock much bigger ache for v backed startu

There's a p here. Tech c nies that are asking top talent to big gamble and hope for outsize bonanzas are keeping their option er companies aren't. For many emp of big companies, once the bright e ria of the market bubble was gor tions turned out to be less terrif

BRADLEY C. BOWER/BLOOMBERG NEWS

ACCOUNTING REFORM

Earnings: It's Still Apples and Oranges

After battling for more than 12 years, the Financial Accounting Standards Board has finally come to the moment of victory in its drive to see companies record expenses for stock options paid to employees. Over the next several weeks, most companies will start factoring options expenses into their quarterly earnings results.

But investors won't suddenly get clear visions of company profitability. Resistance among technology executives and the tech stock analysts who go along with them means the phase-in is far from complete. In fact, if anything, investors comparing corporate bottom lines this year will still be looking at apples and oranges, often without realizing it. The reason: A significant minority of companies and analysts still use earnings numbers that exclude or minimize options expense.

Companies have been phasing since June. The added expense wi reduce earnings in the aggregate 3% for companies in the Standar 500-stock index, accounting anal Zion of Credit Suisse Group estim last year using 2004 data, the mo available. But the impact could be that because many companies in back on options grants or change estimates of their value to reduce they'll have to report.

The clarity the change is suppo bring has been muddied. At least companies papered over their sto costs before coming under the rul vesting their options grants early, to a report by accounting analyst Ciesielski in *The Analyst's Accoun Observer*. The move effectively pu past expenses that would otherwi counted over the next few years. It

pe. Options are not as attractive at nies like Microsoft, Pfizer, and Warner, whose stock prices have en in years. There, options can be a l reminder of the might-have- Companies that have eliminated s now talk about the value of cash. ney might have a point. An Aetna sman argued that a $500 check is a rable replacement for a typical 00 a year employee who would otten options under the old plan out 45 shares of stock. A Time r spokeswoman points out that employees would rather get cash tock options that over the last few nave given them little.

ch points up an unfortunate truth options: They are a great way to let yees share in the wealth at a com- whose stock is rising dramatically, most other cases they don't make very good incentive at all. When ere easy to give out, options were is a magic potion that would make yees come to work every day hop- increase the stock price. But moti- employees is just not that simple. for that matter, is motivating CEOs. The history of the options boom is instructive here. The seminal moment for options was a 1990 paper by economists Michael C. Jensen and Kevin J. Murphy that argued that American companies didn't give CEOs enough incentive to worry about the stock price. Jensen and Murphy knew that giving top executives options would likely mean bigger pay packages, but they didn't anticipate how much bigger. (Murphy now says he feels like a doctor whose patient started swigging a bottle of wine a day when he prescribed a glass.)

Time Warner employees may now prefer cash over stock options

And what did the bigger pay packages accomplish? It's not clear. Murphy, now at the University of Southern California, thinks that better-designed—and, yes, bigger—executive pay packages may have helped create the stock market boom of the late 1990s. But the link between pay (options) and performance (stock boom) is tenuous. Consider this: Murphy and Jensen ended their article with a list of 25 companies that gave their CEOs the most sensibly structured package of incentives. Among their selections: Enron, Pan Am (which declared bankruptcy just months after publication), UAL, Toys 'R' Us, and others just as dreary.

Now, with the new rules in place, the options game has come full circle. First they looked like a nice incentive for CEOs. Then, when it became clear to everybody that you could give any number out and still declare profits every year, they seemed like a good idea for all. Now that they are a lot harder to give out, they don't look so irreplaceable after all. Companies have found they can live with their top tier of executives getting fewer options and the corporate middle fewer still. So some of the options have disappeared. But the outsize pay packages that options mania brought about still remain. ■

–With Louis Lavelle in New York, Amy Barrett in Philadelphia, Dean Foust in Atlanta, and bureau reports

Analyze This

Some analysts are counting options expense on their earnings estimates. Others are not. There are:

156
Companies with a majority of analysts excluding options from earnings estimates

326
Companies with a majority of analysts including options in earnings estimates

18
Companies with option impact insignificant or unknown

Data: Thomson First Call

ugh three years before that ploy plays ff, says David Bianco, chief U.S. equity rat st at UBS Investment Research. Until em arnings for those companies will look ette han those of competitors that didn't set gimmick, all else being equal.

That is just one reason why comparing price-earnings ratios across companies is perilous. For nearly one-third of the stocks in the S&P 500, a majority of analysts still exclude options expense when calculating their profit estimates, according to earnings tracker Thomson First Call, which provides the estimates used by Yahoo! Finance and other Web sites. The omission, which isn't usually flagged on free sites, makes shares of companies with a lot of stock options expense look cheaper than they really are. Shares of NVIDIA Corp., for example, traded recently for about 20 times this year's analysts' estimates but 24 times estimates counting the options expense. Victory can't be declared by accounting regulators without those basic numbers in synch. Until that happens, confusion reigns. Investors without access to expensive information services will likely suffer disproportionately.

The good news? The stock market has already taken much of its hit for the cost of options in the five years since the Enron Corp. and tech-stock collapses put options accounting front and center on the reform agenda. The debacles prodded institutional investors in many stocks, but not all, to focus on the shareholder wealth employee options were spiriting away. "The market has been resetting gradually for stock option expense," says Bianco of UBS. "At this point, the vast majority of it is already priced in." Phew.

–David Henry

ILLUSTRATION BY ANTHONY RUSSO

SOFTWARE

MICROSOFT'S SLO-MO SCRAMBLE

A new delay in its operating system signals its struggle to keep up in a Net-speed world

BY STEVE HAMM

WHEN MICROSOFT Corp. disclosed on Mar. 21 that the next upgrade to its Windows operating system, called Vista, wouldn't be available for consumers until January, the reaction was one of disbelief. After a five year wait, there would be yet another delay in the release, likely putting a damper on holiday PC sales. "They have totally lost their way," exclaims Michael A. Cusumano, a professor at Massachussetts Institute of Technology's Sloan School of Management. Some employees have lost patience, too. Mini-Microsoft, an anonymous insider, posted a blog item calling for heads to roll: "People need to be fired and moved out of Microsoft today. Where's the freakin' accountability?"

Though Microsoft isn't moving people out, it is moving them around. Sources say that Steven Sinofsky, who has run the company's Office franchise, will be tapped to oversee the next version of Windows. The news was first reported in *The Wall Street Journal*. It amounts to a demotion for Brian Valentine and Chris Jones, the two executives with hands-on responsibility for Windows Vista. Microsoft declined to comment on the move.

Yet the delay raises larger questions about Microsoft's ability to innovate at today's pace. While the company dominated the PC era, it now finds itself in a Web free-for-all. Its strategy of taking years to update its software looks positively archaic compared with fleet Internet companies such as Google Inc., which seem to unveil new software every few weeks.

Today, Microsoft's Windows is the equivalent of an unwieldy supertanker. One reason is that during the period Microsoft was being prosecuted for antitrust violations, the company integrated many new features and functions into the operating system—including its Web browser. That created a huge tangle of interdependencies. Vista is loaded with 50 million lines of computer code and has involved thousands of programmers. And even after Microsoft completes a new operating system, it needs to spend about a year testing how it will work with a dizzying array of hardware. It tests the software on hundreds of PC models and thousands of printers, keyboards, and other peripherals.

Some outsiders believe it's time for drastic action. "I'd like to see them build a new operating system from the g up that's much simpler and smaller MIT's Cusumano.

Microsoft is experimenting with ways of developing software. La vember, Microsoft Chairman Bill announced new online applicatio der the umbrella of Windows Li Office Live. The company has lau test versions of a dozen service more are on the way. The new speed is evident. Its classified ad W was created in four months by five "I can do quick-twitch releases mo says Blake Irving, a corporate vice dent for MSN Communications.

But these are all pieces of softwa run on top of Windows. Microsoft that it doesn't need to overhaul proach to developing that all-imp software. "Nothing about the ann ment says there's something fund tally wrong with the Windows n says Brad Goldberg, general man Windows product management. S says, the company plans to deliver Windows upgrades more frequentl releases could come out every year

Yet the software giant may be fo make more substantial changes to t it builds Windows. Delays like tho Vista could hurt the loyalty of cons and corporations, especially as st alternatives emerge from Apple Co Co. and the Linux operating syste less Microsoft comes out with Wi upgrades more quickly and smoo risks losing ground in the rapidly ing world of computing. ■

Vista's Long Road

Here are key milestones in Microsoft's road to delivering Vista, the next version of its Windows operating system:

OCT., 2001
The release of Windows XP, the predecessor to Vista. Development had already started on the next version, then code-named Longhorn.

AUG. 27, 2004
Microsoft says it will elimin some of the planned featur Longhorn, renames it Vista says it will ship in the seco half of 2006.

NOV. 1, 2005
Chairman Bill Gates annou a new generation of online software services, Window and Office Live, designed t compete with Google and Yahoo! in the consumer ma

MAR. 21, 2006
Citing testing and quality reasons, Microsoft announc delay in the release of Vista, pushing the versions for consumers and small busin back to January, 2007.

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SCHAEFER His stock has returned 10% a year for a decade with little volatility

STOCKS

ISS LOOKS LIKE IT'S CHANNELING ICAHN

The proxy advisory firm says Fifth Third's CEO should go despite stellar governance

BY EMILY THORNTON

WHAT ARE SHAREholders supposed to do when a company with stellar corporate governance practices loses value for five years? Should they vote to reelect the CEO to the board of directors or oust him?

That's the question facing the 148-year-old Cincinnati-based retail bank Fifth Third Bancorp. On Mar. 10 proxy advisory firm Institutional Shareholder Services Inc. in Rockville, Md., advised its money manager clients to reject the bank's CEO, George A. Schaefer Jr., for reelection to the board. Why? "Consistent underperformance" of the bank's stock over the last five years, both on an absolute basis and relative to its peer group.

Yet Fifth Third is an overachiever in corporate governance. It has better practices than 99.8% of the companies in the Standard & Poor's 500-stock index, according to the ISS report. "Effective corporate governance is a key ingredient to a company's success," Schaefer boasted in 2003, when ISS scored the bank highly. "We are pleased to have these efforts recognized by ISS."

That was then. Now, shareholders may vote to get rid of Schaefer at the company's annual meeting on Mar. 28 based on the recommendation by ISS that they withhold their votes for directors up for an uncontested reelection, including Schaefer. "I have a tough time reconciling how we could get a corporate governance score better than any other bank in the universe and then [ISS advises a no-vote] based solely on share price," says Schaefer.

A Lending Laggard

Fifth Third Bancorp's stock has trailed the market for five years

	PERIOD OF RETURN*		
	1-YEAR	3-YEAR	5-YEAR
Fifth Third	–17.26%	–11.22%	-6.72%
S&P 500	4.91	14.39	0.54

*Annualized returns

Data: Institutional Shareholder Services Inc.

In the pa like other advisers, ered stoc formance the context of an overall score on rate governance criteria rangin board members' independence to tive compensation. Now, ISS' philosophy is starting to resemble self-styled shareholder activists Carl Icahn and Kirk Kerkorian message to corporate boards: Cre ue or scram.

OVERSTEPPING?

ISS IS ANSWERING the call of n vestors who agree. In a survey las ber, 58% of ISS' clients said long- nancial performance should be a f vote recommendations for or aga rectors. So ISS now evaluates com returns on a stand-alone basis ov three-, and five-year periods with ings of 20%, 30%, and 50%, resp "Job No. 1 for the board of directo produce returns for shareholder ISS special counsel Patrick McGu

ISS says its clients' focus is shi companies' performance in part so much progress has been m many corporate governance fronts the past five years. ISS is targeti the worst performers, and even t financial results aren't examined i uum. ISS says it won't ding CEOs new or appear to be taking substa tions to correct matters.

Yet the definition of sufficient tive action is fuzzy. In Fifth Thir ISS said the bank lacks a "demo turnaround strategy." But in 200 Third added 63 banking centers creased its salesforce by 1,400 po

Some analysts worry that ISS stepping its expertise by makin calls on performance. On M Richard X. Bove of investmen Punk Ziegel & Co. fired off a resea calling ISS' advice "totally inappro and pointing out that Fifth Third have increased tenfold since S took over in 1990. Nell M former president of I now runs governance res The Corporate Librar warns that ISS may cre centive for earnings ma tion that may not be in th holders' long-term i —precisely the sort of good governance is supp prevent.

ISS argues that Schae

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sided over the erosion of nearly 7% of shareholder value over the last five years. But rival proxy adviser Glass, Lewis & Co. in San Francisco is advising clients to re-elect Schaefer in part because Fifth Third has outperformed the S&P 500, with less volatility, over 10 years. "Who wouldn't like a stock that has returned 10% annually to shareholders over 10 years with very little volatility?" wonders Glass Lewis Chief Executive Gregory P. Taxin.

Schaefer will learn the answer at the bank's annual meeting. Meanwhile, ISS estimates that CEOs of as many as 70 other companies it evaluates may be on the hot seat this year. Expect sparks. ■

BusinessWeek online For more on the Institutional Shareholder Services debate, go to www.businessweek.com/extras

INFLATION

WHAT YOU FORESEE IS WHAT YOU GET

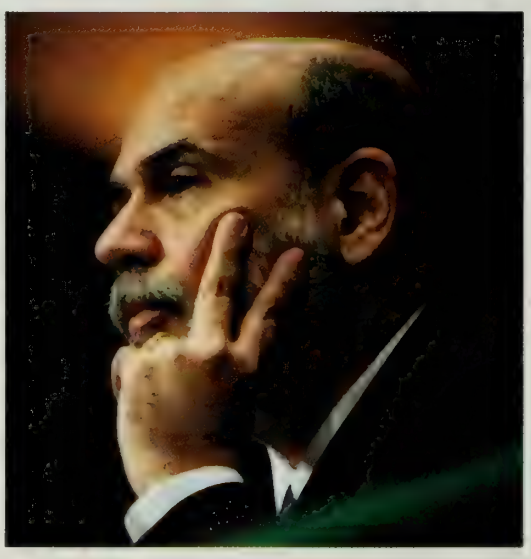
Expectations of future price hikes may play a big role in how much and how fast the Fed raises rates

BY CATHERINE YANG

WHAT THE HECK are inflation expectations, anyway? You won't find the term in any of the major economic data releases put out by the government. Yet whether inflation expectations are rising or falling may turn out to be a critical factor in determining how far and how fast the Federal Reserve raises interest rates.

That, at least, is the new line coming out of the Fed these days. Inflation expectations—a bit of a touchy-feely concept—represent the beliefs of consumers, investors, corporate execs, and economists about how fast prices will rise in the future. To new Fed Chairman Ben S. Bernanke, inflation expectations are a key indicator. If people believe inflation will stay low, the Fed can afford to relax a bit. But if the masses start anticipating faster inflation, the odds are greater that the Fed will need to hit them with higher rates even if actual price hikes remain moderate.

The good news, for now, is that "long-term inflation expectations [are] apparently anchored at low levels," as Bernanke noted in a Mar. 20 speech. By some measures, inflation expectations are a bit lower than a year ago. That suggests the Fed will be more likely to stop raising rates sooner rather than later after its expected quarter-point hike, to 4.75%, at the Mar. 27-28 meeting of the Federal Open Market Committee (FOMC).



"Long-term inflation expectations [are] apparently anchored at low levels."

–Fed Chairman Ben S. Bernanke

Bernanke has some critical allies on the policy-setting FOMC, including Janet L. Yellen, president of the Federal Reserve Bank of San Francisco. On Mar. 13, Yellen gave an entire speech about the importance of inflation expectations also noted that "clear communicatio numerical long-run inflation objecti something Bernanke supports–help keep expectations in line.

How are beliefs about future infl measured? One way is to ask econo what they think is going to happer cording to the Philadelphia Fed's S of Professional Forecasters, econo expect consumer inflation to av 2.5% over the next 10 years, only above their 2.45% forecast of a year er. That's not very worrisome.

CREDIBILITY CUSHION

ANOTHER WAY TO JUDGE expecta is to look at the behavior of investor particular, the people who buy Tre Inflation-Protected Securities (T which are indexed to inflation to gi vestors a fixed real return. The sprea tween 10-year TIPS and regular 10 Treasuries, a measure for expected age annual inflation over the next de is 2.68%, according to calculatio Timothy S. Fuerst, an economics p sor at Bowling Green State versity in Ohio. That's slight low the 2.72% of a year earl

The danger, of course, i expectations about future p might jump, forcing the F raise rates sharply to mainta credibility as an inflation fi That's what happened i 1970s, when the public's l faith in the Fed's inflation- ing resolve sent prices—an pectations of future inflat spiraling out of control aft oil shock.

Contrast that with today Fed has built credibility by aggressively fighting inflatio communicating its commi to price stability. As a result as energy prices skyrocketed cent years, inflation expect hardly budged, and non-e inflation stayed relatively lo

The emphasis on expect could also be Bernanke's v getting people used to the controversial idea of setting tion targets. After all, if the going to react to beliefs abo ture inflation, it's only natural for th tral bank eventually to specify exp the acceptable level of inflation.

But that's a debate for later. For with such benign expectations for tion all around, the Fed has finally b itself a little breathing room. ■

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200605

GLOBAL MEDIA

AL JAZEERA MEETS AMERICAN RESISTANCE

Its English-language news channel can't find a U.S. carrier, but that won't stop its launch

BY STANLEY REED

WHEN EXECUTIVES for broadcaster Al Jazeera first planned a new 24-hour English language channel, the idea was to offer viewers an alternative to CNN, the BBC, and other Western news outlets. They hired such heavyweight talent as veteran TV host Sir David Frost to lend cachet. What they didn't prepare for was the cold shoulder they would receive in the U.S.

Just two months before its scheduled launch, Al Jazeera International still has no distributors in the important U.S. market, despite talks over the past year with nearly all the big players, from Comcast to Time Warner to DirecTV.

It's not just the controversial nature of Al Jazeera that gives distributors pause, say some cable executives privately. Whether it's a convenient cloak for them or not, they say it also makes little economic sense for them to pay a fee for yet another channel in the overly fragmented 400-channel TV universe. Satellite service EchoStar Communications Corp., the lone distributor in the U.S. of the Arabic-language Al Jazeera, is the only company expressing any interest so far. "We would be willing to consider carriage," EchoStar spokeswoman Kathie Gonzalez told *BusinessWeek* in an e-mail. She declined to comment on the status of talks.

SERIOUS BACKING

NO MATTER HOW daunting its prospects, the new channel has the enthusiastic backing of Qatar's ruling Al-Thani family. Tiny Qatar has the world's third-largest natural gas reserves and fast-accumulating foreign assets, now estimated at $30 billion. Unlike Western broadcasters facing constant financial pressure, the Qataris are willing to fund the new outlet indefi executives say. But it will share so sources with the Arabic channel, w million viewers.

The American snub hasn't diss the Qataris from giving the new ch the money to lure such on-air pers ties as Veronica Pedrosa, a CNN As chor, Dave Marash, a corresponde ABC's *Nightline*, and Rageh Omaa BBC's former Baghdad reporter. T traction? Explains Frost: "I try where the new frontiers are if I ca them, and obviously Al Jazeera is much the new frontier at the mome

Few experts expect the chan draw a mass audience. "There is a core of news junkies in America wh be interested," says Richard Wal Fred Friendly Professor at Col University's Graduate School of Jo ism. But to have a significant impa says, Al Jazeera will have to offer than just Middle East expertise. says he'll be featuring topical politi terviews but lightening the lineu guests such as Paul McCartne David Beckham.

As tough as it has been in the U Jazeera execs say they a willing to compromise a deal. Commercial di Lindsey Oliver says cab erators are in a posit drive a hard bargain, i ing forcing new chan agree to skip streamin the Internet to reduce petition. But that's not worth making, she say

Besides, Oliver con initial numbers in th are not crucial to Al J International, addin channel's target is a English-speaking aud not just an Americ Oliver figures that the nel will have 40 m households locked u launch time, thanks to with Britain's Britis Broadcasting Group P well as distributors in Australia, France, an many. But without th Al Jazeera may not be ing all of the frontie David had in mind. ■

HEADQUARTERS Al Jazeera's high-security Doha offices

Getting Snubbed In the U.S.

Al Jazeera International, the 24-hour English-language news channel, has had trouble hooking up a cable or satellite distributor. Some stats:

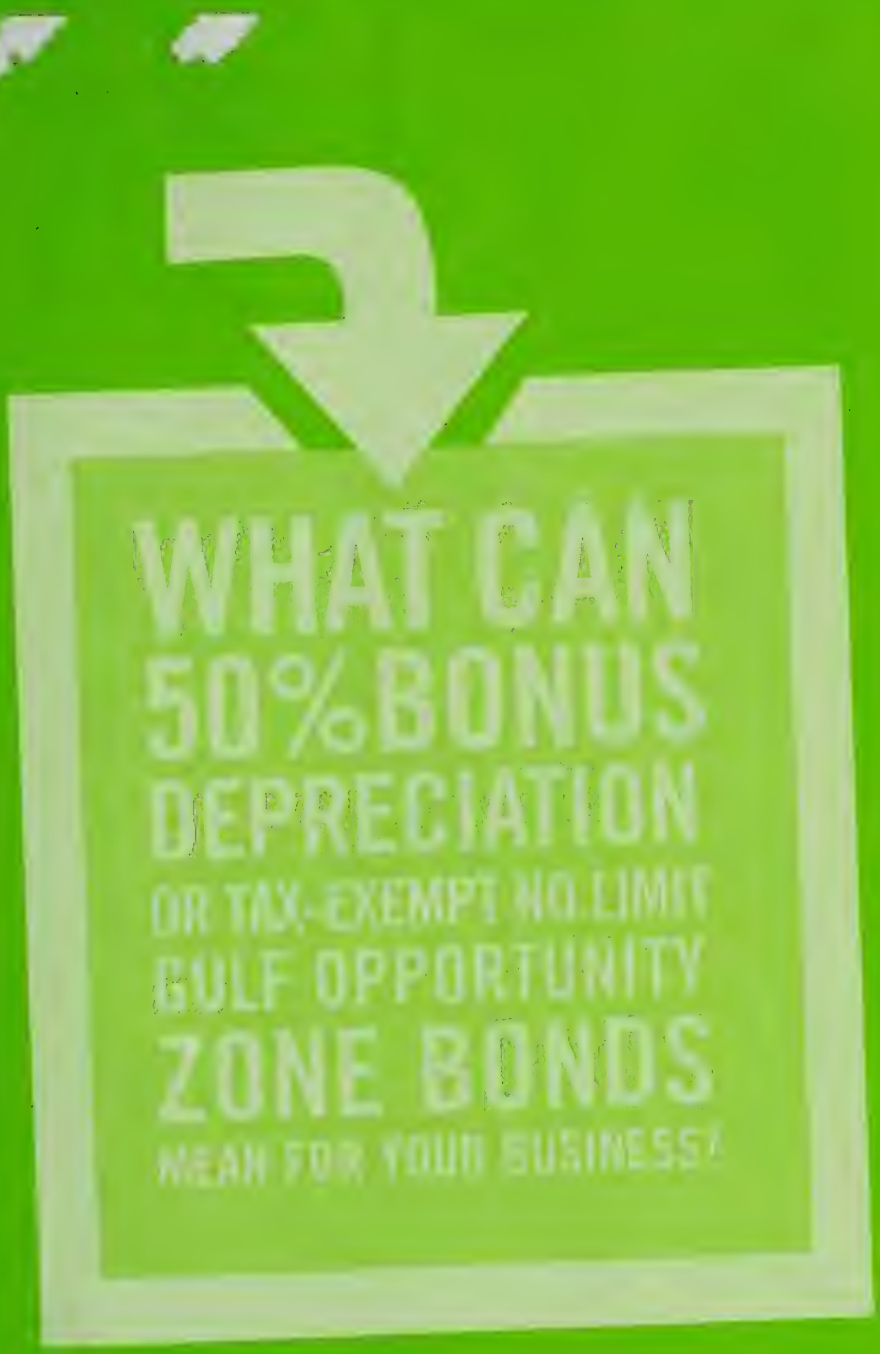
0
The number of distribution deals in U.S. so far

40 Million
Estimated number of households outside the U.S. that will receive the new channel

$30 Billion
The foreign assets of Al Jazeera's main backer, the tiny nation of Qatar

Data: Al Jazeera International

BusinessWeek online Fo interview with David Fro Al Jazeera International, businessweek.com/extra



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EDITED BY RICHARD S. DUNHAM

Senator Inhofe's Climate of Confrontation

BY JOHN CAREY

THE REVEREND RICHARD CIZIK IS AN EVANGELICAL Christian and a die-hard Reaganite. So he was surprised that a closed-door meeting called late last year by conservative Senator James Inhofe (R-Okla.) was all about Cizik's evil deeds. Inhofe said Cizik, government affairs chief at the National Association of Evangelicals, a liberal wolf in sheep's clothing. "I sat there with my mouth open," recalls a meeting participant.

Cizik's sin? He believes that climate change is a growing problem, and that Christians have a duty to protect the planet by cutting emissions of greenhouse gases. In contrast, Inhofe, the chairman of the Senate Environment & Public Works Committee, has famously derided global warming as a "hoax." He has been on the offensive against those he considers heretics. That has left business in doubt about the regulatory environment.

Seeking Tax Records

LAST YEAR, Inhofe demanded years of tax and membership records from two dozens of state and local air-pollution control officials after they testified that his proposed clean air legislation was too weak. On Feb. 7, days before evangelicals kicked off a campaign for carbon controls, Inhofe sent a preemptive letter to senators asserting "there is, in fact, no movement in that direction" among evangelicals. Now he is requesting information on all employees and projects at the National Center for Atmospheric Research. Inhofe is "using the power of government and the power of office to intimidate," says Donald Kennedy, editor-in-chief of *Science*.

Inhofe's backers say he is providing a badly needed voice of reason amid environmental alarmism. Inhofe spokesman Marc Helbrook says the senator was traveling and not available to comment. But Inhofe has argued consistently that global warming science is uncertain and carbon curbs would ruin the economy.

This may sound like another inside-the-Beltway spat, but the business consequences could be huge. Adding to the scientific evidence of global warming, *Science* published two papers on Mar. 24 warning of a possible large sea level rise. Executives such as Jim Rogers, CEO of Ohio utility Cinergy Corp., believe the U.S. inevitably must join other nations in curbing carbon. They want clear rules so they can plan future power plants. "Climate change is a key issue for Corporate America," says Mindy S. Lubber, president of the Coalition for Environmentally Responsible Economies. U.S. businesses are behind overseas rivals in developing climate-friendly technologies, she adds.

ON THE ATTACK Inhofe says global warming science is flawed

Companies are caught in the middle. In this political climate, "business leaders are holding back from saying publicly what they believe privately," says William Reilly, Environmental Protection Agency chief for George H.W. Bush and a DuPont director. Adds an industry rep: "If we say anything positive, the environmentalists come after us with a vengeance. If we say anything negative, Inhofe comes after us with a vengeance."

Some green conservatives are speaking out more. "Inhofe is to the right of Attila the Hun on climate change," says the Reverend Jim Ball, director of the Evangelical Environmental Network. Meanwhile, Environmental Defense and the Ad Council were set to unveil an ad campaign on Mar. 23 aimed at boosting public awareness of climate change. If more Americans come to believe the problem is urgent, eventually even Inhofe may not be able to hold back the tide. ■

CAPITAL INSIDER

SMALL BUSINESSES: NO CHILL FROM SARBANES

TO HEAR BIG BUSINESS tell it, the regulatory reforms of the 2002 Sarbanes-Oxley Act are driving companies out of public financial markets and starving small businesses of capital. But that message apparently hasn't reached Little Business. A record 881 small companies filed with the Securities & Exchange Commission in 2005 to register new stock issues and raise $16.3 billion in new capital, according to a study by researchers SME Capital Markets. That's up from 435 in 2003. Critics note that the SEC has deferred SarbOx' Section 404, the internal-audit requirement that businesses consider burdensome, until 2007 for little companies. But small-business CFOs interviewed for the study say they would have gone public even if 404 applied to them, because they see no choice for raising capital.

MORE COMPANIES AGREE TO DISCLOSE DONATIONS

ADVOCATES FOR shareholders are making headway in their bid to prod companies to disclose soft-money political donations. Bristol-Myers Squibb and Staples are the latest businesses to agree to reveal and give their boards oversight on soft money donations—the large contributions that companies and individuals can make to state parties. In addition, Amgen's board has endorsed a shareholder resolution calling for oversight and disclosure. Shareholders will vote on the plan at its May annual meeting. Companies that earlier agreed to disclosure and oversight are Morgan Stanley, Johnson & Johnson, Schering-Plough, PepsiCo, Coca-Cola, and Eli Lilly.

ENTREPRENEURS

EBAY'S RHINE GOLD

Thousands of German startups are using the auction site to sell goods

BY JACK EWING

IN THE U.S., GROUND ZERO OF modern capitalism, it is almost an article of faith: Europeans have grown risk-averse and lack entrepreneurial zeal. But don't tell that to the thousands of folks who use eBay Inc. to do an end run around decades of state-imposed regulations and old ways of thinking. One of them is German businessman Norbert Otto, who recalls the exact moment he realized selling ski gear over eBay had become far more than a hobby for him.

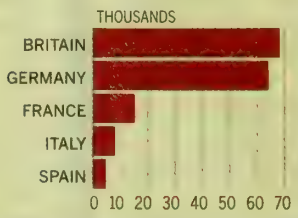
When Otto printed out his checking account statement at a local bank's automated teller machine, the statement had so many pages that the branch manager scolded Otto for tying up the ATM for so long. Soon after, Otto opened a commercial account for Sport Otto, his online business, which last year sold $1.8 million worth of skates, skis, snowboards, and other sporting goods exclusively over eBay.

Not bad for an operation that began three years ago as a way for Otto's son to earn extra cash. Today, Sport Otto has 25 part-time employees, a large truck to haul merchandise from Dutch ports, and operations that occupy much of Rabenkirchen, a hamlet of just 60 inhabitants two hours north of Hamburg. In this region close to Denmark, where old-timers speak a dialect incomprehensible to outsiders and unemployment is 12%, Sport Otto is one of the few local employers creating new jobs. "We're very thankful that this online platform exists," says Otto, 58, a sports instructor by profession who manages the business with his 20-year-old son, Jan. "In this region, it's the only chance we have."

The Ottos' small-but-thriving operation provides a window into one of Europe's fastest growing entrepreneurial sectors: the eBay store. According to a survey by ACNielsen International Research, the Ottos are among 64,000 Germans who earn at least 25% of their income from eBay, selling all manner of collectibles, furniture, electronics, and more. Germans snatched up $6 billion in merchandise on eBay in 2004, the most recent year for which such data are available.

THEY'VE GOTTA HAVE IT

Entrepreneurs who earn at least 25% of their income from eBay businesses



Data: eBay Inc.

Germany's eBay market is second only to the U.S. A decade of slow growth and stagnant wages has turned Europe's largest economy into a nation of bargain hunters, with 20 million registered eBay users. That's close to 25% of the population, a greater share than in any other country in which eBay operates. With eBay gaining momentum, its success in Germany could portend a similar boom in France, Italy, and elsewhere in Europe.

In red tape-bound Germany, starting an eBay business is a relative snap for anyone with broadband and inventory and shipping software, which is readily available for a few thousand dollars. And logistics companies such as Germa office Deutsche Post offer service lored to small e-commerce opera Compare that with the difficulties o ing startup financing in a country banks are reluctant to lend and rela few people own houses that can se collateral. Even those who scrape t er funds are constrained by myriad lations. Shops, for instance, must cl Sundays and by 8 p.m. on weekday

GIANT CUSTOMER

SOME EXPERIENCED business see eBay as a growth opportunity otherwise slack economy. In 2003 Asböck and Frank Hoffmann, wh worked for a mail-order compan went bankrupt, launched DTG Dyn Trade in Neumünster, an hour no Hamburg. The business snatches sorts of surplus merchandise, the the stuff on eBay. Sales have d every year, to $6 million in 2005, a company employs 22 full-time w "We sell everything you can ima says Asböck. No kidding: Current ings include bedroom sets, toaster telescopic rifle sights.

The business of supporting G e-merchants has also grown into a ing industry. More package deliver generated by eBay for Deutsche Po its DHL unit than the biggest catal tailers. One customer is Bielefeld-SE.LL Marketing, which helps cust such as toy train maker Brio unlo

TEAM OTTO In a slack economy, eBay is a growth engine

es merchandise on eBay. SE.LL rarely ve sees the goods it auctions off, having ut urced the warehousing, packing, hipping to DHL. "We want to focus rvices. Fulfillment is not our core ess," says SE.LL co-founder tof Sander, 29, a former manager at an media company Bertelsmann.

Rabenkirchen, eBay—combined the easy availability of logistics es and software—has created a d of e-commerce. For two decades Otto coached basketball, track, and other sports at municipal sports clubs and ran a ski shop on the side. But then the financially strapped local government cut his hours in half, and a recession devastated his shop's sales. In 2002, when son Jan, then 17, asked for money for driving lessons, Norbert told him he would have to earn it by selling off some of the ski shop's excess inventory. The skis sold quickly on eBay—at twice their wholesale price.

Soon Jan found himself behind the wheel of a battered blue cargo van, ferrying Chinese-made parkas and plastic sleds from the port of Rotterdam. Sport Otto began hiring staff, using part-timers to avoid paying health and pension contributions that can nearly equal an employee's take-home pay. The fledgling company also took over a cluster of small buildings in Rabenkirchen that had been vacant ever since the former tenant, a construction company, shut down.

BUYING A BENZ

AT FIRST GLANCE, the Ottos don't appear to run an especially tight ship. Swim goggles, baseball bats, and mosquito nets are arranged haphazardly on wooden shelves. Yet every item is bar-coded and scanned. From a desk equipped with two flat screens and littered with wholesale sporting goods catalogs, Jan knows when to redeploy snowboarding trousers from the barn to the packing shed. As customers bid, software tallies the average price and profit on each sale.

The business hasn't made the Ottos rich. Their one luxury is a Mercedes-Benz SUV. Jan lives in the same building used to pack orders, while Norbert occupies a modest apartment above Sport Otto's offices. Both start work at 7 a.m. and often don't finish until late in the evening. They dream of building a modern, computer-driven warehouse and buying products directly from Asian suppliers. For now, Norbert says, "we're investing everything back into the business." Spoken like a true entrepreneur. ■

–With Robert D. Hof in San Mateo, Calif.

HINA

A Behemoth Kept at Bay

When Gary Wang wanted to buy a microphone for his iPod, he didn't bother with eBay EachNet, the Chinese arm of eBay Inc. Instead, vent to rival site TaoBao, quickly found t he wanted, and paid for the gadget n TaoBao's electronic payment system. got the machine by courier the same day. Bao is naturally the first place I go" n shopping online, says the 32-year-old g, an eBay user during his studies in the and now CEO of Toodou, a podcasting pany in Shanghai.

hat kind of enthusiasm has made Bao China's No.1 auction site, leaving eBay in the dust. TaoBao last year was home to 72% of China's $1.7 billion in online auctions, measured by the value of goods sold, compared with eBay's 27%, according to the China Internet Development Research Center. That spells trouble for eBay's international ambitions, especially in the world's No.2 Internet market, with 110 million Netizens and Web auction transactions that grew 235% last year.

THE UNDERDOG The auction site lags far behind homegrown TaoBao

TaoBao stole the lead by offering its services for free. And TaoBao's founder, Jack Ma, has been better at creating tools users like, including an electronic payment system and an instant messaging service for traders. "Jack Ma believes in building community first" and will worry about profits later, says Morgan Stanley analyst Richard Ji.

But eBay is determined not to repeat its experience in Japan, where it beat a humbling retreat in 2002. So in January it scrapped transaction fees and now charges sellers as little as 1¢ per item for listings. Then in February, eBay added a feature allowing traders to talk via Internet phone links. Important steps, and vital if eBay wants to stay in the game in China.

LEGAL EAGLE
If Yoko Mukai passes the bar, she'll enter a good job market

JAPAN

LAWYERS WANTED. NO, REALLY

Once litigation-averse, Japan is rushing to fill a shortage of attorneys

BY IAN ROWLEY AND KENJI HALL

REMEMBER THIS OLD chestnut? If you were to lay all of America's lawyers end-to-end on the equator...it would be best to leave them there. Well, it now appears that Japan might have room for them instead. After decades of enjoying one of the world's smallest concentrations of attorneys, the country is embarking on a program to mint thousands of new ones every year.

For much of the postwar era, Japan didn't feel it needed many lawyers. That worked in a consensus-driven society bent on economic growth. Court battles in Japan were always a last resort and considered very bad form. Today, with patent disputes and cross-border mergers on the rise, the nation is discovering that legal sharpies actually come in handy when settling disagreements. But with just 22,000 licensed attorneys, compared with more than a million in the U.S., "it's extremely difficult to get talented lawyers [in Japan]," says Stephen Bohrer, an American who heads cross-border transactions at Nishimura & Partners, a big Tokyo law firm.

Japan's legal community finally seems to be getting serious about easing the shortage. In 2004 the government for the first time allowed universities to begin offering graduate programs in law. Since then 74 new law schools have opened their doors, with the first graduating classes—some 3,000 students—to hit the streets this spring. Prior to the shift, Japan's sole graduate-level legal program was a two-year course of study sponsored by the Supreme Court—but it was only offered to those who managed to pass the bar exam first. And only 1,000 to 1,500, or about 3% of those who sit for the test, were allowed to pass annually. That meant most candidates took the bar exam at least five time fore they pass or gave up.

Tokyo is its best to mak new schools attractive. This year th results will be weighted so that ab third of grads pass, leaving just 500 for the 40,000 or so exam takers didn't attend one of the new program 2010 the government plans to doubl number of test takers allowed to pas exam, to about 3,000, with most of t crease going to grads of the new sch "Law school has expanded my poss ties," says 30-year-old Yoko Mukai, signed up for a $15,000, two-year cou the University of Tokyo School of Law failing the bar several times in the pa

MERGER MAVENS

WHAT WILL JAPAN do with all its lawyers? Given that the economy is g ing at its fastest clip in years, demar savvy merger attorneys is surging. Japanese companies are turning to t gal system to settle disputes that might have been worked out in rooms. In 2004, for example, Sumi Trust & Banking and Mitsubishi Tok nancial Group faced off in court afte Holdings pulled out of a planned dea Sumitomo and merged with MTF stead. "In the past [such a court b would never have happened," Masatomo Suzuki, a partner in Tokyo Cleveland-based law firm Jones Day.

With so many new schools starti at once, growing pains are inevitable concern is finding enough qualifie fessors. And some fret that it might fair to give law school grads a leg the bar exam. "Everyone is wat closely to see what kind of people t churn out," says Robin Doenicke, a ner at Zensho Consulting Group, a search firm in Tokyo.

Despite the changes, it's unlikely will ever fully em the kind of legal c common in the U.S gation is messy an in the face of Japan tural preference fo mony. But a more s ticated, and conten legal system may b what the country in order to keep it nomic overhaul on And that means t ing unseemly cour brawls that once have shocked. ■

THE STAT

People per Lawyer

JAPAN
5,800

U.S.
270

Data: Japan Federation of Bar Associations, American Bar Assn

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Coffee, Tea, or Mortgage?

Banks are cozying up to customers while using high-tech tools to identify prospects

BY MARA DER HOVANESIAN

BARCLAYS BANK PLC WAS long the dominant credit-card player in the British market, until American rivals showed up a few years ago with cutthroat pricing and direct-mail sales tactics. Barclays had been getting more than 80% of its new customers the old-fashioned way—from application forms stacked in piles at its local branches. It needed to raise its game, but how? The storied lender fired up its database of 10 million bank account customers, augmented it with demographic and behavioral data and credit bureau information, and came up with a list of customers who were inclined to sign up for more services. Then it started selling them stuff.

The strategy worked. Barclays went from attracting around 500,000 to 700,000 credit-card accounts a year to more than 1.7 million by 2005. It also began tracking credit-card purchases and capturing what customers are looking for on its Web site to fine-tune promotions and spur sales in other parts of the bank. "The future will be driven by customers who are signaling [what they want] through the Internet and other areas," says Keith Coulter, managing director at Barclays U.K.

Ah, the Internet. That's where savvy shoppers call up the latest and best rates on any number of financial products and services and sign up for them in a matter of minutes. Add to that the emergence of peer-to-peer banking in the form of PayPal Inc. and Prosper.com—which cut out banks entirely—and the possibility of Wal-Mart Stores Inc. entering the business, and you have the perfect conditions for what industry people call churn, and what the rest of us call defections.

That's why banks are in full-scale makeover mode. Washington Mutual Inc., a pioneer in adopting sales strategies perfected by retailers, routinely hires people from Starbucks and other places to drive sales. But it's doing far more than just calling branches "stores" and recasting tellers as sales associates. WaMu Chief Operating Officer Stephen J. Rotella calls it a "cultural awakening."

Banks are adopting strategies long known to retailers

The most forward-thinking banks, among them Wachovia Corp. and Bank of America Corp., are enlisting architects to redesign their sleepy storefronts, behaviorists to profile customers, and high-tech consultants to rev up their 21st century marketing machines with high-tech gadgetry and systems. Susan Duchesneau, client relationship manager in the financial services unit at SAS, a business intelligence and analytics firm in Cary, N.C., says banks "will know how to predict the future and change their customers' behavior."

In the past year, Bank of America has invested heavily in creating a single repository of consumer data to get a of what customers are likely to do when they are likely to do it. "We ar creasingly capable of predicting b says Cathy Kenworthy, who heads sumer marketing at Bank of Ame "But compared with the retailers, got a long way to go."

STAY AWHILE
Relaxing at Wainwright Bank

A long way indeed. Banks attract than a third of the $3,500 that the age American household spends year on financial services. To ca more market share, they must sell ucts across the entire financial spect from brokerage services to home-e lines, certificates of deposit to c cards. And once they succeed in sc new business, they must hold onto i

HOLISTIC VIEW

INCREASINGLY, THEY'RE betting technology will get them there. Th turning a massive volume of transact from credit-card purchases to onli

PLAYBOOK: BEST-PRACTICE IDEAS

The Toaster Is Toast

The latest tactics banks use to grab your attention

GIVE THEM GOODIES

Umpqua Bank of Roseburg, Ore., hands out Umpqua chocolate and has a digital music kiosk so customers can rip and burn tunes onto CDs

HOME AWAY FROM HOME

A plasma TV and lo free coffee and dou and a cybercafe lur customers and non customers to **Wain Bank & Trust in Bo**

es and call-center complaints, into f intelligence used to piece together ic pictures of customers's wants and s. "Business intelligence [helps] pin- who might be interested in particu- oducts," says Mark N. Greene, vice- dent for strategy at IBM's Financial ces group.

stly, banks mine for behavioral such as when a customer is about itch banks or may be in the market ore services. If, say, a couple has re- paid for flowers, an expensive cake, tropical vacation, chances are they wlyweds—and might soon want a age. What's more, Barclays isn't the ne zeroing in on its best prospects. ear, Wachovia created profiles of 1.2 n of its most profitable customers, signed "financial specialists" to call o see if there's anything they need. fort contributed to a 9% increase in erage customer balance last year.

ks are also trying to make their customers "stickier"—more likely to hang around a branch. It's no easy task. Industry studies show that pedestrians walk faster past a bank than past other establishments. Some banks are redesigning branch offices to be more engaging, with play areas for kids and digital music kiosks for their parents. Tiny Wainwright Bank & Trust Co. in Boston has turned bank design on its head. It invites people—customers or not—to surf the Web at its cybercafe, cozy up on the couch and watch TV, or sit by the fireplace and enjoy free goodies from Dunkin' Donuts.

Following the credit-card industry's lead, some banks are offering membership rewards for the first time. Citibank's ThankYou Network, launched in April, 2005, offers loyalty points redeemable for goods and services. The program has attracted 9.3 million accounts so far. "The objective is to create an experience that is very unbank-like," says Paul Kadin, marketing director at Citibank North America, whose promotion budget now includes "appreciation stations" with simulated surfing, golf, basketball, and other leisure experiences.

Banks are also monitoring spending patterns and targeting people accordingly. For instance, "if they figure out people shop at Starbucks seven times a week, they could offer free lattes," says Trevor Rubel, vice-president for products at Intelligent Results Inc., a predictive modeling outfit in Bellevue, Wash. "Or if someone is shopping at Home Depot several times a month, a bank can offer a home-equity product. It all comes to getting back to a banking relationship that you know and [that] knows you."

STRATEGIC WEAPON

TECHNOLOGY IS allowing banks to pitch products far outside the confines of branches. BlackBerry and cell-phone alerts tell customers about current promotions. And call centers are turning into marketing centers. Cleveland's KeyCorp identified life-stage markets, such as Young Transactor, Family Asset Builder, and Mature Thriver based on surveys about attitudes, aspirations, and demographics. Incoming calls from electronically tagged customers are routed to trained operators, who are prompted with cues on how to steer the conversation. "Call centers were an operational utility, a necessary evil," says Trina Evans, director of KeyCorp's centers, which have seen a 150% increase in sales since 2003 without an increase in staff. "Now we are a channel to drive business and a strategic weapon for the company."

In the near future, banks will embed chips in ATM cards that alert managers when preferred customers have walked in the branch door. Voice recognition and semantic engines on voice call systems will be rewired to indicate that a caller may be a promising sales prospect. Microsoft Corp. says it hopes to position its Xbox 360 video-game console as an engaging financial tool. "If a bank produced a game that allowed you to simulate what impact your current decisions will have on the future, you and your family could have some serious fun," says Bill Hartnett, general manager of strategy for Microsoft's Financial Services Group.

Human contact is still the marketing vehicle of choice, however. "We have all the traffic we need and then some," says Bank of America's Kenworthy. "Our marketing challenge is to make our associates more effective. That's the whole enchilada." ■

N APPEAL

rgh-based PNC branches appeal to logically minded ergy-efficient and countertops f recycled paper stainable wood

FREE TICKETS

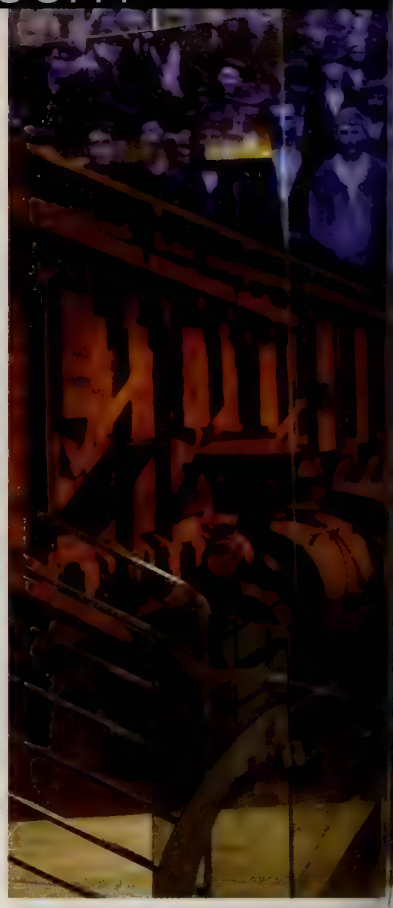
Bank of America of Charlotte, N.C., offers free tickets to 50-plus museums in the Northeast to customers during May, National Museum Month

COMMUNITY OF INTERESTS

First National Bank of Hermitage, Pa., has a Lifestyle 50 club that organizes trips for fiftysomethings to exotic destinations

Time to 'Make a Buck in the Muck'

Mine operator Phelps Dodge aims to strike while the copper is hot



BY CHRISTOPHER PALMERI

AMID THE PRICKLY PEAR cacti and greasewood shrubs of Safford, Ariz., something else is blooming: jobs. Over the past three years, the town's largest employer, mining giant Phelps Dodge Corp., has added 300 positions at its nearby facilities. Many more are coming as the company hopes to begin construction this summer on the first major new copper mine in the U.S. in over 30 years.

It represents a rich vein of cash for Safford, a hamlet of 9,600 hardy souls in the desert 165 miles southeast of Phoenix. Housing starts are up and new restaurants have opened, bringing new customers to establishments such as Nikki's Hard Rock Beauty Shop. "Our Wal-Mart got super-sized," says Sheldon Miller, director of the local chamber of commerce. "It's like jump-starting the economy."

The global boom in commodity prices is breathing new life into communities such as Safford, and giving an even bigger boost to Phelps Dodge, the largest copper miner in the U.S. Copper prices have surged from 78¢ to $2.34 per pound in the past three years, as strong demand from China and India at times exceeded the industry's ability to produce the metal. Last year, Phelps Dodge earned $1.5 billion on sales of $8.2 billion, after posting a loss of $338 million as recently as 2002. The company's stock price has shot up sixfold since then, to a recent 74 per share.

For Chief Executive Officer J. Steven Whisler, the new prosperity is bringing its own challenges. A Phelps Dodge employee for three decades, the 51-year-old Colorado Springs native has seen copper prices ebb and flow and knows the importance of planning for the bad times. He has quadrupled capital spending to $700 million a year, split the stock, paid down over $1.7 billion in debt, and earmarked $935 million to cover retirement, health care, and environmental clean-up costs. That means that the company's pension plan is now fully funded. "Almost every week you pick up a newspaper and an American icon is struggling with its pension liabilities," Whisler says. "That creates stress with our employ

Even after all of Whisler's shorin of the balance sheet, he still had a pot of $1.9 billion, and just $677 mi in debt, at the end of 2005. He has b returning a big chunk of cash to sl holders: Since December the com has paid out $900 million, or $4.5 share, in special dividends. It plans t tribute at least another $600 millio the end of 2006.

For some shareholders, though, efforts aren't enough. Atticus Ca LLC, a New York City-based ac hedge fund that controls 10% of the pany's shares (half of that in the fo

Turning Copper into Gold

Copper prices have tripled in the past three years, making Phelps Dodge Chief Executive J. Steven Whisler a very popular man. Here's how he's trying to please his various constituents.

EMPLOYEES Creating hundreds of jobs with $1.6 billion in capital projects, including the first major new copper mine in the U.S. in over years. Also put $535 million into trusts to shore up retiree health-care and pension accounts.

ENVIRONMENTALISTS Putting $800 million into cleanups at older mi sites, winning kudos from activists such as Nancy Freeman, who's gett new wells and water testing for her hometown of Green Valley, Ariz.

SHAREHOLDERS Paying out $1.5 billion by the end of this year in spec dividends or share buybacks. Hedge fund Atticus Capital, however, wa billions more, something Whisler calls "a reckless bet that could threa our company's future."

CEO WHISLER "You have to plan...on the down cycle to survive the tough times"

s), has been pushing the company ark on a multibillion-dollar stock-hase program, arguing that shares lervalued. In a letter on Feb. 15, At-ecutives Timothy R. Barakett and Slager told Whisler they had hired advisers to consider options, in-selling the company out from un-. "A significant buyback of stock is y the right thing to do for your olders; it is your surest guarantee ndependence," the letter states. An At-okesman declined comment.

AL SAGA

ER FIRED BACK in a press re-alling Atticus' demands "a reck-that could threaten our compa-ure." Interviewed three weeks Phelps Dodge's copper-topped arters building in downtown , Whisler was less combative but olved not to bend in order to tticus. "We've seen a few cycles l probably see a few more," he this business, you have to plan s on the down cycle to survive h times."

ompany has had more than its ough times. Founded in 1834 as rk-based trading house, Phelps among the last independent oducers, as once-storied names such as Anaconda and Kennecott have been snapped up by foreign rivals. *BusinessWeek* included Phelps Dodge in a 1984 cover story called "The Death of Mining" that featured an ingot with handles on it made to look like a coffin. It was an era Whisler remembers well.

Then a young lawyer at the company's head office, he spent six months in 1983 filling in for striking workers at the massive Morenci mine, about 50 miles northeast of Safford. Whisler drove a dump truck, changed tires, and pulled copper sheets from the smelter. Ultimately, the mine workers voted the union out. "We spent a long time trying to educate employees that copper prices were low, we were losing money, and had to do some different things," Whisler says.

Those different things include deploying new technology. In the 1980s, Phelps Dodge began to replace many of the smoke-belching smelters long used to refine copper with a leaching process that uses chemicals to extract minerals from ore. Whisler is investing $210 million in a new leaching facility at Morenci. By first pulverizing rock to the consistency of sand, the process will allow Phelps Dodge to obtain copper from ore it otherwise couldn't have, extending the life of the 125-year-old mine. The process came out of the company's 130-person technology unit, based in Safford. "We're just trying to make a buck in the muck," says the unit's general manager, Rick Gilbert.

Getting approval for a new mine took 12 years of persistence

Whisler is also directing capital to plant expansion. He's in the middle of an $850 million addition to a mine in Peru that will triple production there, to 600 million pounds per year by the middle of 2007. By 2008's second half, Whisler hopes to have the $550 million Safford mine up and running.

Getting approvals from state and federal authorities for the new mine took 12 years of persistence and paperwork. The project's manager, Steven Holmes, followed in the footsteps of his now-deceased father, who tried to develop an underground mine in the hills above Safford in the mid-1970s.

The current mine deal involved a controversial land swap with the Bureau of Land Management that environmentalists and a local Apache tribe protested as fraught with ecological risk and a bad deal for the government. In combination with the Peruvian project, the Safford mine should help lift the company's annual copper production by 20%, to 3 billion pounds by 2010.

And therein lies a debate over copper prices and Phelps Dodge's future. Copper bulls argue that continuing demand from construction markets around the world, coupled with the difficulties producers have had adding new supply, should keep prices high or rising for years to come. In 2003, China overtook the U.S. as the world's largest copper consumer.

But copper demand isn't as strong as prices suggest. Last year worldwide usage actually fell 1.5%, according to the International Copper Study Group, a research organization sponsored by copper-producing countries. Robust growth in China, India, and Russia did not offset declining demand in the U.S., Japan, and Europe. On the New York Mercantile Exchange, copper trades at $2 per pound for delivery in February of 2008, high by historical standards but below today's price.

Whisler is thus in the awkward position of cheerleading for his chief product while also trying to temper expectations. He has spoken about a "second copper age," one in which more of the world's 4 billion people lacking plumbing and electrical connections gain access to such copper-dependent services. At the same time, he's cautious. "There's a fair amount of financial money in commodities today," he says. "Is that creating some froth? Yes. How much, I don't think anybody knows."

Can Whisler manage to please both Safford and New York? It's a delicate balancing act for a CEO, even in a boom. ■

Innovation: The View from the Top

IBM's honcho on what CEOs can do to lay the groundwork for real breakthroughs

IBM CONDUCTS A SURVEY OF CEOs and government leaders every two years to find out what's high on their agendas. This year's topic: innovation. Some results were surprising. Business-model innovation scored high, especially at top-performing companies. And execs now see collaboration with other companies—even rivals—as indispensable. Senior Writer Steve Hamm interviewed IBM Chairman Samuel J. Palmisano about the findings. Here's an edited version of their conversation.

Innovation is a hot button for chief executives. What's driving that?

CEOs and business leaders around the world see increased competitiveness, and they see challenges in their business models going forward. They see many things commoditizing. They see that all roads lead to innovation. With the Internet and the proliferation of semiconductors, you'll end up with trillions of things connected—not just individuals but cars, roads, homes, appliances, health-care data, and pacemakers. All of these things are available today that weren't available in the past.

In a way, everybody needs the challenge or the threat to get them going. The threat is that all these competitors are coming online that have global capabilities. They're all enabled by these technologies. The opportunity is to take advantage of the fact that we have low-cost transistors, RFID [radio frequency identification] tags, and supercomputing that is inexpensive and pervasive. All of a sudden, this infinite computing capacity is available, and it's economically affordable to solve many of the world's more complex problems. So my colleagues, other CEOs, look at this thing and say, "You know, geez, the opportunities are everywhere. So how do I take advantage of it?"

PALMISANO "Everybody needs...the threat to get them going"

Your survey found that business-model innovation has become a focus for CEOs.

People realize that you need to do innovative products. You need to have your products differentiated. But with product innovation, it's a certainty that your competition is shortly going to copy what you've done. There was just an announcement that Samsung has a pretty cool way to listen to music as an alternative to the iPod. There will always be the next hot car and the next great high-definition television. But with all of those things, your competition's going to react to what you've just done. It might take them a year or two, but it's inevitable. They will react.

With business-model innovation, though, if you can come up with a u way of doing things, it's much toug react to. The holy grail of strategic t ing is, how do you come up with a ness model that differentiates you that creates value for your custo and, by doing that, puts you in a u position in your industry?

Why is business-model innovation so much harder to achieve than produc innovation?

It's because organizations have inh resistance to change. Look at [how I has taken] IBM. Years ago we t about remixing our product portfol talked about moving to the high-val novator spaces in technology and se because there's more profit-margi portunity. Now, the profit of our po is mixed a third, a third, a third—ser software, and systems and technol

The next step to drive producti we're going to globalize IBM. We'r tening our structure and having co ration hubs established aroun world, and rebalancing all thos sources. That's 330,000 people.

There's a lot of inhere sistance to this shift an change. With many co nies, what makes it hard is not necessarily settin strategy but executin That's where it requires leadership from the CE well as collaboration groups outside of your o ganization. You need to c orate because the collabo is so important to learni

Is collaboration with busin partners a key part of bus model innovation?

Our point of view is sim today's environment, with all the opportunities that exist and thes technologies, the best way to make unique for your own enterprise is to collaboration. You can do that in m dimensions. You can collaborate your own organization. We can be cultural and diverse in IBM becau happen to be in 173 countries arou world. So, by definition, there's a can do amongst ourselves to colla with different views of opportu technology within our diverse popu

In addition, you need to collabor tween companies and governmen educational institutions. I think th breakthrough that we got done in t processor, which is based on our

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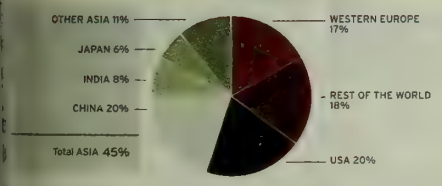
DAVID MACKAY, PRESIDENT AND CHIEF OPERATING OFFICER, KELLOGG COMPANY

Australia | the place to grow your business in the world's fastest growing region

Asia-Pacific is fast becoming the engine room of world economic growth. In the next ten years, it is forecast that Asia's economies will account for 45%[1] of world GDP (GDP based on purchasing power parity), significantly more than the United States and Europe combined.

SHARE OF WORLD GDP[1] IN 2015



Australia's strong business and cultural links with Asia, and with a time zone that straddles the Asian, European and US business days, Australia is ideally placed to provide the skills, resources and high quality services to meet Asia's development needs. Australia's top four merchandise trading partners are Japan, China, Korea and the United States[2].

Australia is well known for its commodity exports, services accounting for almost 80% of economic activity[2]. Over the five years to end 2004, Australia's services exports to China almost quadrupled, while services exports to India and Korea increased by 13 and 86 per cent respectively[2].

No country in the Asia-Pacific region can match Australia's range of multilingual skills, and its education system is ranked in the world's top four in meeting the needs of a competitive economy[3]. Our workforce is also ranked first in the Asia-Pacific for overall productivity per person employed[3].

Australia's regulatory environment is business friendly. Of the 30 OECD countries, Australia is ranked as having the fewest restrictions on product markets and the least restrictive impact of regulation on economic behaviour.

So, with Australia still ranked the world's most resilient economy, your investment decision could not be simpler. The future is here – in Australia

Well known for its great-tasting, high-quality foods since 1906, **Kellogg Company** is the world's leading producer of cereal and a leading producer of convenience foods.

Kellogg Company enjoys projected annual sales of more than US$10 billion with products manufactured in 17 countries and marketed in more than 180 countries around the world.

The Australian operation was the first Kellogg facility to be established outside of North America with Australian production commencing in 1924. Realising the market potential, Kellogg increased its investment in Australia, building a new plant in Sydney in 1928. This facility's port-side location provides Kellogg with easy trade access to the booming Asia-Pacific region.

Kellogg Australia continues to invest in its Sydney plant and has acquired another manufacturing facility. This expansion has been undertaken to meet the needs of the growing domestic cereal market, snack food industry, as well as catering for the demands of export success.

AUSTRALIA | AT A GLANCE

Most resilient economy in the world for the fourth year in succession (IMD WCY 2005)

Lowest risk of political instability in the Asia-Pacific (IMD WCY 2005)

Experienced a 90% increase in the stock of foreign direct investment over the last five years to a record US$211b in December 2005 (ABS 2006)

15 years of continuous expansion with forecast growth of 3.2% in 2006 compared to the OECD average of 2.9% (OECD 2006)

One of the lowest cost business destinations in the developed world (KPMG 2004)

Fastest place in the world to start a business (World Bank 2005)

Ranked second in the Asia-Pacific for patent and copyright enforcement (IMD WCY 2005)

[1] Consensus Economics; IMF: economics @ ANZ **[2]** Australian Bureau of Statistics 2005 **[3]** IMD World Competitiveness Yearbook 2005

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architecture, would not have happened if we hadn't designed chips for Sony, Toshiba, Microsoft, and Nintendo. Now, clearly, some of these folks are easy to collaborate with because they aren't in our space—Sony or Nintendo. But the other two are clearly competitors of IBM—Toshiba and Microsoft. Yet at the end of the day, it was through these collaborations that we were able to get through this incredible breakthrough. Now we're applying that breakthrough to all sorts of places, whether it's high-definition television, consumer electronics in the home, high-definition radar systems, or medical imaging.

We also started collaborating with communities of experts. It started with Linux and the open-source community, where we all come together and share in some of these areas of technology and standards.

Another thing that you found in your survey is that the CEOs feel they have to personally lead the innovation campaign.

With product innovation, if you stand up on your soapbox and you cheer a little bit, that will certainly help. But the reason I think that the CEOs have to lead this is because, fundamentally, the biggest breakthroughs are a result of changing the business model and the processes and the culture. When you say the new strategy is going to be to change the business model, every CEO understands that's their job. When you talk about driving culture or management systems to change your culture, my colleagues all understand that's their job. So CEOs realize that they have to get these new types of innovation done through their own leadership.

We all do it in different ways. Go back even 10 years ago. Was it natural for IBM to go collaborate around the future of innovation or the future of our technologies? Was it natural for us to open up to the world the things we solved technically as we were inventing things to get feedback on where that was going? Was it natural for IBM to join into the open-source community to talk about standards around lots of technologies? These weren't natural things to occur. The CEO has to give permission to the organization to have it happen. If the CEO doesn't give people permission to go change behavior and to collaborate, then it's not going to happen. Everybody is looking for the signal. They want to know whether things are really changing fundamentally.

A Big Push for the Very Small Screen

Putting broadcast TV on cell phones cou make Qualcomm a media power

BY RONALD GROVER

PAUL E. JACOBS IS DEFINITELY not made from the TV executive mold. The 43-year-old CEO of Qualcomm Inc. has a PhD in electrical engineering and made his mark at the cell-phone chipmaker by writing software code to compress speech. But these days Jacobs is sure talking like a TV guy, chatting about 15-second commercials and consumers' viewing tastes with the gusto of a media mogul. "The cell phone is the TV of the future," he says. "And the future isn't that far

Real media moguls have no reas worry—yet. San Diego-based Qual and its $5.7 billion-a-year collecti patents and licenses won't be taki CBS anytime soon. But as every company from Apple Computer I Google Inc. maneuvers to make n by showcasing video, Jacobs is in a r make the cell phone your TV on t Later in the year, Qualcomm plans fer the cell-phone industry's first b cast TV service. Called MediaFLO expected to include 20 channels of TV-quality programs, 10 music cha

the cell-phone equivalent of a TiVo in · palm, with the ability to store pro- nming in the memory of your phone e played back later. "It's the ultimate ving consumers TV when and where y] want it, and that has become cru- ' says Joseph Rizzo, U.S. tech-sector f at PricewaterhouseCoopers. Media- plans to sell the service to cell-phone iders for a cut of subscriptions, simi- the way TV programmers negotiate ibution on cable and satellite. (Its deal so far is with Verizon Wireless.)

T-GENERATION NETWORKS

PAYOFF COULD BE huge. Within years, as many as 26 million cell- e users could be spending $3 billion r on video subscription services, fig- technology researcher IDC. With a ntial market that vast, it's no surprise comm is facing growing competition. lready in a race with phone services offer their own versions of video on o. What's more, a consortium that des phonemaker Nokia, chip giant Microsoft, and Texas Instruments to offer a rival service, Modeo, later ear based on technology being tested eral European markets.

aking TV programming available ell phones isn't a new notion, of e. But interest so far has been scant, rt because rather than actually casting, current efforts involve loading shows and sports from s, forcing consumers to wait for es that can be fuzzy and intermit- The leading service, MobiTV, has 00 subscribers who pay $9.99 a n to watch clips and programs 20-odd channels, including Fox s, Discovery, and MSNBC. Qual- and the next generation of TV net- intend to make the picture better, ing the same broadcast towers and ded analog spectrums used by the broadcasters. The result: a TV-like experience, with sharper pictures and live video, all on a two-inch screen.

For Qualcomm, the MediaFLO network is a bold departure from its start in silicon and software. Three years ago, as TV companies were being pushed by the federal government to trade their analog spectrum for new digital signals, Qualcomm paid about $87 million for the nationwide rights to the slice of the UHF spectrum that had been reserved for channel 55. With plans to spend up to $800 million, Qualcomm devised compression technology to jam channels into that spectrum. It is also providing 800 minutes of short programs stored in the memory of cell phones that can be replayed later. "We're very geeky around here, so we wanted to make this the very best we could," says Peggy L. Johnson, president of Qualcomm Internet Services.

But the competition is pushing ahead with technology, too. Modeo will use the existing broadcast towers owned by Crown Castle International, which controls more than 10,000 U.S. sites. Taking over spectrum once used by weather-balloon operators, Modeo has tested its service in Pittsburgh and plans an initial rollout in the top 30 U.S. markets, says Modeo President Michael Schueppert. Qualcomm says only that it will launch initially in half of Verizon's markets. Verizon declined to comment.

MediaFLO, a separate unit of Qualcomm, is becoming a sort of mini media company. It has hired TV producers from New York and Los Angeles to create original programming and has started talking to advertisers about "aggregating eyeballs." Gina Lombardi, president of MediaFLO USA Inc., says the company is ironing out distribution deals with programmers. These are believed to include NBC, MTV, and ESPN. Neither she nor the rumored partners would comment further.

There are huge hurdles to entering a business as entrenched as entertainment. TV networks, worried about how their local affiliates would react to the competition, have yet to sign on. And there is no agreement yet that would outline how to share ad revenues with the phone services, says Lombardi. That is making some phone outfits nervous. "It is a proprietary system, and that gives us pause," says Paul Reddick, Sprint's vice-president for business development.

Then there's the larger question of whether folks will even want to watch a palm-size TV. A spate of recent studies shows that consumers want their phones mostly to make calls (box). Jacobs blames the lack of interest on less-than-great experiences with handheld TV. So he knows the pressure is on to deliver. "If we don't do this right," Jacobs frets, "there won't be TV on cell phones for two generations." ■

TV in Your Pocket

Video and broadcast TV on cell phones are about to explode. A few market projections:

26 MILLION
Number of subscribers to mobile-video services by 2009

$3 BILLION
Revenues generated by mobile-video subscriptions by 2009

$1.26 BILLION
Spending on cell-phone ads in 2009

Data: IDC, Ovum

A VERTISING

Call It a Sell Phone

Cell-phone users may balk at receiving video and advertising on their handsets, but ad rtisers are ready to spend. ven if 71% of people su eyed last month by market re archer RBC Capital Ma ets Corp. say they don't wa video and ads on their cell phones, advertisers are undeterred. Nearly 90% of major consumer brand marketers in a separate survey say they plan to market their wares via cell phones anyway, according to Airwide Solutions Inc., which advises mobile carriers. Revenue from mobile advertising is expected to hit about $1.3 billion by 2009, up from $50 million in 2005, projects telecommunications research firm Ovum.

Consumers reject the idea of video and ads on phones, say media experts, because they assume it will replicate the Net, where they already feel assaulted by pop-ups and adware. A promising model, though, suggests Rishad Tobaccowala, chief innovation officer at ad outfit Publicis Groupe, is using the cell phone as an "opt-in" ad device. Carriers, he says, would be smart to "incentivize consumers to accept ads relevant to them." One obvious carrot: offer credits to decrease a user's cell-phone bill.

It's not that people hate advertising. They just hate ads that are irrelevant to them. Make it worthwhile, and the cell phone might just become as useful a tool to consumers as TiVo.

–David Kiley

KWATINETZ At first, "Our mistake was doing what everyone else was doing"

West Coast VCs, East Coast Rules

Azure's Wall Street refugees rely on in-depth research—and it's paying off

BY PETER BURROWS

EVEN WITHIN THE CHUMmy world of Silicon Valley venture capitalists, many people haven't heard of Azure Capital Partners. To the extent they have, it's usually because of the San Francisco firm's ties to one of Silicon Valley's infamous characters. Azure's four founders all rose to prominence while working for Frank Quattrone, the former Credit Suisse First Boston rainmaker whose conviction for obstruction of justice was overturned on Mar. 20. (None of the founders was implicated in the investigation.)

Now Azure looks poised to make a name for itself for more positive reasons. After a couple of hits in recent years, it has at least four companies in its stable of investments that could be headed for big paydays in the next year. They include software developer Zend Technologies Ltd., which has been in talks to be acquired by software giant Oracle Corp., and Calix Networks Inc., which could be headed for an initial public offering. Fast-growing Calix, with more than $100 million in revenues, makes gear for telecom companies that want to offer TV and other services. "This will be a scorching IPO," says analyst Sam Wilson of JMP Securities LLC.

Azure isn't your typical venture firm. Rather than depending on partners' gut instincts, it relies heavily on the hard-core research its partners learned on Wall Street. Their approach is to conduct in-depth studies, often taking a year or more, to investigate investment possibilities. That has led Azure to place many of its bets on little-known companies in out-of-favor markets. "They are the quants of the VC world," says Carl Russo, chief ecutive at Calix. "They're either creati very different model for a venture firm there will be a huge waste of mo Azure won't be run-of-the-mill."

Azure saw the potential in open source early on

It wasn't always that way. Azure founded in April, 2000, by First Bos investment bankers Paul Ferris Cameron Lester, as well as research a lysts Michael Kwatinetz and Paul W stein. They easily raised $530 million poured much of it into 20 startups, cluding some high-profile outfits sky-high valuations. When the Net lapse came, they got pounded. "Our take was doing what everyone else doing," says Kwatinetz.

The partners quickly changed tac They made their own research centr their investment strategy, focused on ly-stage deals, and put in money on they could get at least a 25% stake a seat on the board. They also slo down, making only four to six dea year, vs. the 20-deal pace of the first

The approach led them to invest ear several promising tech areas. In 2001 began doing research into open-so software, including interviews with companies in the sector. The result three investments in 2002, when few vestors saw the potential in giving ware away for free. The sector is red today. Zend is likely to fetch $200 milli it's acquired by Oracle or another cor ny. "By doing proactive primary rese it builds your confidence to make cou intuitive bets," Weinstein says.

What are the promising sectors Azure is betting on the ecosystem of panies that work with Microsoft C shunned in recent years because of th ant's slow growth. Azure did some search and decided to take a stak SourceCode Technology Holdings with less than $1 million in enues. Now the company track to pass $50 millio sales this year, making strong IPO candidate.

The Azure method about to supplant the t tional approach of VC lea such as Kleiner Perkins field & Byers. But for nov Wall Street refugees at A are convinced there is for their brand of inves "Back in the 1990s, it was all about to market, and getting eyeballs," says ris. "Now, it's more about finding an nomic basis for success—and that's going to get more important."

—With Justin Hit

What we know about life safety is alarming.

Robert Vincent, Vice President of Operations, Senior Engineering Technician

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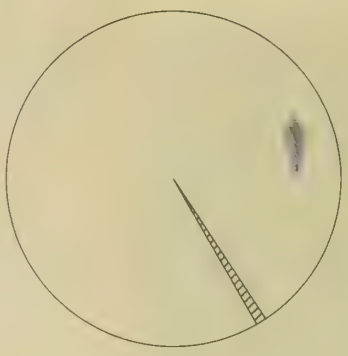
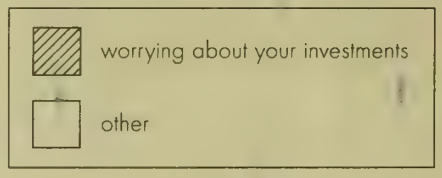
ALLOCATION OF TIME





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THE BUSINESSWEEK 50

The Best Performers **64**

Strategies for Success: Apple **68**
Schlumberger **70** Goldman Sachs **72**
Horton and Lennar **74** FedEx **76**

Investing: Top Prospects **78**

Profiles of the 50 **82**

Performance of the 50 **103**

Full rankings of all S&P 500 companies at BusinessWeek.com/BW50

BusinessWeek online

aking the Grade

ercial Highflier: How UnitedHealth ou a five-time BW50 company d N 4 on our list this year, has ana d to generate earnings gains 3pi 20% year after year. **ww.usinessweek.com/BW50**

e Story Behind the Story: For odcast interview with Atlanta reau Chief Dean Foust by ecu ve Editor John A. Byrne, go to **ww. sinessweek.com/search/ dca ing.htm**

Do you see the forest?
Or the trees?

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The BEST Perfor

2006 With oil prices high, energy's strong showing in this year's rankings is no surprise. But a closer look finds a host of companies that have scored big by building intense customer loyalty.

BY DEAN FOUST

THE LAST PLACE YOU MIGHT EXP to find creativity would be the corner store. But just take a look at CVS Corp. F focused on the pharmacy, creating a sop cated system that allows customers to p in, and then pick up, prescriptions at p times. And after an exhaustive survey of pers, the chain, based in Woonsocket, R.I barked on a sweeping makeover of the its 5,400 stores, focusing on its core female shoppers. Sl that previously stood six to seven feet high were lowered feet, putting every item within view of the average woman CVS found, is 5 feet 4 inches tall). Stores were repainted in designer colors.

Not least, CVS made a major upgrade of its beauty secti hired several hundred beauty advisers, who help shoppers just the right shade of foundation and then recommend cosmetics. And the company added exclusive brands su hair-care products by Beverly Hills stylist Christophe as w Lumene, a Finnish skin-care and cosmetics brand that top-selling beauty line in Europe. The new ranges "have

nergy and momentum for us," says Helena Foulkes, CVS's or vice-president for marketing and advertising. "Our beau- usiness is outperforming our overall store." The innovations paid off for CVS. Same-store sales rose 6.5% last year, help- uel an overall 33% increase in earnings. Investors are raving ell, with CVS shares up 132% over the past three years—a ormance that helped earn CVS the No. 39 slot in this year's nessWeek 50, our 10th annual effort to identify the best-per- ing companies in Standard & Poor's 500-stock index.

me powerful economic and demographic forces favored in sectors this year. With oil at $60 a barrel, energy-relat- ompanies are at the fore. Among them are a number of ce providers, including Baker Hughes (No. 21), National ell Varco (No. 27), and Weatherford International (No. 36). s further evidence for investors that the biggest winners t always the companies digging for gold but sometimes ompanies selling the picks and shovels. And the list was lated, once again, with a number of health-care compa- ncluding Amgen (No. 9) and Aetna (No. 10), a reflection of ging of baby boomers.

l out energy and health care, however, and you'll find a lot cessful companies on this year's BW50 that, like CVS,

mers

their stripes the hard way, by thriving in industries stiff competition and cutthroat pricing have wiped out ompanies. These companies have used innovation—be ugh technology, or clever design and marketing—to win rts and wallets of consumers. And with more and more sses seeing their competitive edge whittled away by the et and globalization, experts say it's imperative for com- always to look for new ways to build, and then maintain, customer loyalty.

petitive Advantage

BEST EXAMPLE MAY BE this year's No. 1 company, Apple nputer Inc., which has used catchy TV ads as well as cutting- chnology to stay ahead of competitors selling MP3 de- ost recently with the video capabilities of its newer age 68). Ditto for 24th-ranked Starbucks Corp., which ng a step ahead of other coffee shops by creating new uch as current fave Marble Mocha Macchiato as well as ng music compilations aimed at baby boomers, all of ive its customers new reasons to keep coming back. es Inc. (No. 44) turned a perpetual source of customers'

THE BUSINESSWEEK 50

1 Apple Computer
2 WellPoint
3 Caremark Rx
4 UnitedHealth Group
5 Schlumberger
6 Occidental Petroleum
7 Halliburton
8 Qualcomm
9 Amgen
10 Aetna
11 Lowe's
12 Burlington Northern Santa Fe
13 Motorola
14 Yahoo!
15 Goldman Sachs Group
16 Lehman Brothers Holdings
17 Gilead Sciences
18 Jabil Circuit
19 Best Buy
20 EMC
21 Baker Hughes
22 Texas Instruments
23 Cisco Systems
24 Starbucks
25 Intel
26 D.R. Horton
27 National Oilwell Varco
28 JPMorgan Chase
29 Merrill Lynch
30 Valero Energy
31 ConocoPhillips
32 Marathon Oil
33 Prudential Financial
34 Microsoft
35 Freeport-McMoRan Copper & Gold
36 Weatherford International
37 eBay
38 Coventry Health Care
39 CVS
40 FedEx
41 Franklin Resources
42 Lennar
43 Coach
44 Staples
45 NVIDIA
46 Norfolk Southern
47 Caterpillar
48 McKesson
49 Hartford Financial Services Grp.
50 Home Depot

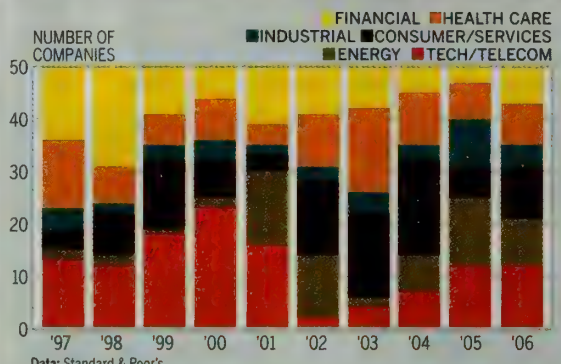
Data: Standard & Poor's Compustat

annoyance—the rebate process that many have grown to distrust—into a competitive advantage. By allowing shoppers simply to file for a rebate at its Web site without photocopying receipts or cutting UPC codes off boxes, Staples has earned the trust and loyalty of millions. Staples says its research showed that 80% of customers found its online rebate process "extremely easy" and—most important—are more likely to seek out Staples for their future needs. "We think the marketing of rebates is a significant positive in terms of brand loyalty and sales," says James F. Sherlock, director of sales and merchandising for Staples. So far, eight million customers have claimed their rebates electronically, and Staples is working to enhance the program further. By early next year it hopes to give customers a choice of a rebate check, direct deposit into their bank account, or the ability to convert the funds into an immediate purchase at Staples.

Several companies have made their mark by providing better service. Adrian Slywotzky, a ce- president at Mercer Manage ent Consulting, notes that L e's (No. 11) and Best Buy (N 19) have both put a premium o- fering more service than the et- ter-known rivals, Home 1 00 and Wal-Mart Stores, respec ely. Lowe's, for instance, has des ed its stores to appeal to w en, with wider aisles that make as- ier for moms to navigate a s ler or shopping cart and better hi- ing. Lowe's also uses a highe re portion of full-time workers in- tend to be more knowledg ble than Home Depot. Best Bu has managed to steal away from Wal-Mart popular brands, su as Samsung Group, that prefer their goods to be displayed i es Buy's bright and lively stores. "This proves that smaller p es who create a different value proposition that emphasizes s ice can compete with the big boys," says Slywotzky.

Marketing savvy may make for profitable businesses, bu it doesn't always produce big returns for investors. While the 50 companies that made last year's roster generated p

EVOLUTION The 50 through the years



Data: Standard & Poor's

THE BEST AND WORST OF THE S&P 500 COMPANIES

EARNINGS Best earnings growth and biggest losses in the S&P 500

TOP TEN (ONE-YEAR)	PERCENT CHANGE	TOP TEN (THREE-YEAR)	PERCENT CHANGE	BOTTOM TEN (ONE-YEAR
TXU	2091%	Phelps Dodge	835.5%	General Motors
CA	1970	Transocean	523.6	CBS
Allegheny Technologies	1727	Avaya	496.6	Unisys
Rowan	693	Robert Half Intl.	457.6	Eastman Kodak
Biogen Idec	541	Apple Computer	318.7	XL Capital
Halliburton	512	Monster Worldwide	315.1	Sanmina-SCI
Agilent Technologies	511	Valero Energy	234.5	Dynegy
Genzyme	410	Devon Energy	230.3	Qwest Communications
Newell Rubbermaid	405	Monsanto	221.9	El Paso
Freeport-McMoRan C & G	392	Symbol Technologies	212.6	Tenet Healthcare

TOTAL RETURNS The best and worst in shareholder returns among the S&P 500

TOP TEN (ONE-YEAR)	PERCENT CHANGE	BOTTOM TEN (ONE-YEAR)	PERCENT CHANGE	TOP TEN (THREE-YEAR)	PERCENT CHANGE	BOTTOM TEN (THREE-YE
Express Scripts	131.8%	Gateway	-49.8%	Allegheny Technologies	1673.4%	Tenet Healthcare
Advanced Micro Devices	121.6	Lexmark International	-41.2	Apple Computer	812.6	New York Times
Corning	112.8	General Motors	-39.2	Advanced Micro Devices	604.4	General Motors
Broadcom	109.8	Symbol Technologies	-34.3	TXU	603.4	Tribune
Allegheny Technologies	107.3	Ford	-34.2	E*Trade Financial	509.0	Unisys
Tellabs	106.9	RadioShack	-33.1	Allegheny Energy	497.0	Ciena
Ciena	103.0	Apollo Group	-32.9	Williams	479.4	Lexmark International
E*Trade Financial	92.8	Avon Products	-31.1	Valero Energy	463.8	Maytag
Allegheny Energy	88.9	Sanmina-SCI	-29.9	Monster Worldwide	456.6	Merck
Office Depot	85.4	Tenet Healthcare	-27.7	Circuit City Stores	453.9	Fifth Third Bancorp

Data: Standard & Poor's Compustat, Thomson First Call

rns over the ensuing 12 ıths, the group as a whole d to beat two of the major xes. The BW50 stocks ed an 8.2% return in the through Mar. 14, 2006. 's better than the 5.5% total n for the Dow Jones indus- average, but below the gain of the S&P 500 and 12.7% earned by the DAQ Composite index.

at's no big surprise. The 0 has a growth and mo- tum bias. It tends to shine ng years when the market ing quickly—and performs well in grinding markets. last year's class was held back by the tech sector, with Elec- c Arts, Dell Computer, and Symantec all suffering losses of or greater. But as the saying goes, it's not a stock market, market of stocks, and there are plenty of ways to mine the 0 for investment ideas (page 78).

ch isn't as dominant this year, and given the diversity of this list, we've selected a cross section of companies to profile: Apple, which built on the popularity of the iPod to become this year's star performer; FedEx, which has ridden the manufacturing boom in China better than any delivery company; two standout homebuilders, Lennar and D.R. Horton; Goldman Sachs, which continues to spin profits out of its proprietary trading; and Schlumberger, whose heavy investments in R&D and technology made it a standout in the energy-services field. What they all have in common is that they have developed products and services that are distinct from the rest of the herd. In addition, we've included brief snapshots of each of the BW50 companies. And we round out this year's coverage with statistical tables that provide performance rankings for the BW50. The full ratings for the S&P 500 appear on BusinessWeek Online. Read on. ■

–With William C. Symonds in Boston, Brian Grow in Atlanta, and Fred Katzenberg in New York

METHODOLOGY How we measured the top 50

ONE OF THE BUSINESSWEEK 50'S MAIN GOALS is to capture the dynamic nature of strong growth. That's reflected in how we identify the best of the Standard & Poor's 500-stock index. We use 10 performance metrics, starting with sales and earnings growth. We tally both for the most recent 12-month and three-year periods, to reward companies that prosper over time. This year, for the first time, we include long-term earnings prospects. We factor in net profit margins. And finally we account for the market's view, by measuring total shareholder returns for one- and three-year periods.

We weight the results for sales volume, because it's harder for large companies to post impressive revenue- and profit-growth figures. And we factor in the debt-to-capital ratio, to recognize clean balance sheets. That also makes it harder for corporations to qualify with growth that's primarily the result of debt-laden acquisitions.

GROWTH The best and worst in sales performance among the S&P 500

(ONE-YEAR)	PERCENT CHANGE	BOTTOM TEN (ONE-YEAR)	PERCENT CHANGE	TOP TEN (THREE-YEAR)	PERCENT CHANGE	BOTTOM TEN (THREE-YEAR)	PERCENT CHANGE
	117%	OfficeMax	–31%	Biogen Idec	92.6%	Dynegy	–28.6%
well Varco	100	El Paso	–27	Chesapeake Energy	82.0	CBS	–17.6
ıgs	93	Teradyne	–24	Yahoo!	80.6	El Paso	–16.6
ancorp.	91	Duke Energy	–19	Caremark Rx	78.3	J.C. Penney	–14.9
	80	American Electric Power	–15	XTO Energy	63.3	Cooper Tire & Rubber	–11.2
MoRan C&G	76	Applied Materials	–14	Gilead Sciences	62.1	Clear Channel Communs.	–9.7
Energy	72	Solectron	–12	eBay	54.9	ConAgra Foods	–9.6
uter	66	Forest Laboratories	–12	Constellation Energy Group	50.7	CMS Energy	–9.3
es	59	Electronic Arts	–10	WellPoint	47.5	Citizens Communications	–7.2
	57	Sanmina-SCI	–9	EOG Resources	46.8	MeadWestvaco	–6.8

RGIN Best/Worst, S&P 500

05)	PERCENT	BOTTOM TEN (2005)	PERCENT
cial Group	45.3%	Ciena	–85.0%
	42.7	CBS	–57.2
e	41.2	Dynegy	–34.7
ıent	41.1	JDS Uniphase	–32.3
ology	40.3	Unisys	–30.1
es	40.1	El Paso	–17.3
	37.4	XL Capital	–11.2
	36.1	Eastman Kodak	–10.2
sources	35.7	Sanmina-SCI	–8.9
	35.2	Tenet Healthcare	–6.5

LONG-TERM EARNINGS GROWTH Best/Worst, S&P 500

TOP TEN (2005)	EST. GROWTH RATE	BOTTOM TEN (2005)	EST. GROWTH RATE
Nabors Industries	59.5%	Citizens Communications	1.0%
Newmont Mining	50.0	United States Steel	2.0
Transocean	50.0	Qwest Communications	2.0
Noble	43.0	CenturyTel	2.5
Rowan	33.0	Merck	2.7
Yahoo!	25.7	Verizon Communications	3.0
Jabil Circuit	25.0	American Electric Power	3.0
National Oilwell Varco	25.0	Equity Residential	3.0
eBay	25.0	Consolidated Edison	3.5
Weatherford Intl.	25.0	Progress Energy	3.5

ard & Poor's Compustat, Thomson First Call

THE BUSINESSWEEK 50

STRATEGIES FOR SUCCESS
APPLE COMPUTER

iPods, Sure. But Don't Go Dissing Macs

BY PETER BURROWS

BOYS' LIFE Shopping for Apple computers in New York's SoHo

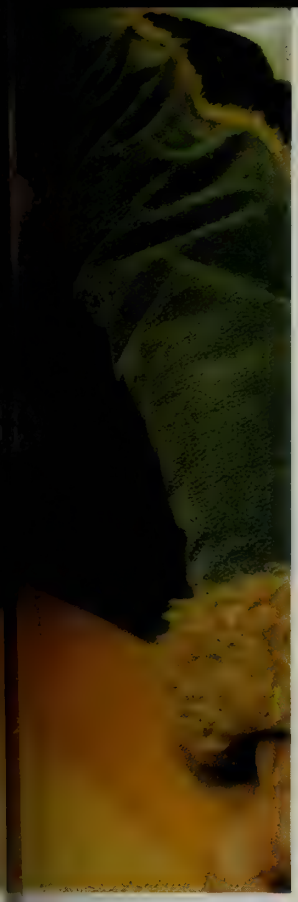
#1

IT'S REMARKABLE THAT APPLE Computer Inc., heading the BusinessWeek 50 list of the best corporate performers, was on the brink not so long ago. "Oh, the company was going bankrupt, all right," recalls ex-board member Edgar S. Woolard Jr. But in mid-1997, Woolard called Steven P. Jobs and asked him to retake the helm of the company Jobs had co-founded in 1976. In short order, Jobs tightened up operations, re-energized Apple's talented troops, and in 2001 oversaw the debut of a magical little device called the iPod.

Those cute gizmos, in their various digital-music-and-video-playing incarnations, have made Apple more powerful than ever, a Wall Street darling that has the early lead in the race to define the world's digital media future. The question of Apple's social and cultural impact was perhaps settled once Jobs was the subject of a *Saturday Night Live* parody (for cranking out iPods so small they're invisible). But the question still dogging investors, who have bid up Apple shares more than 100% since January, 2005, to around $64, is: Can the company keep it up?

The answer will depend not only on successive generations of the iPod but also, to a large degree, on Apple's Macintosh PCs. While the iPod gets most of the headlines, the Mac still brought in 39% of Apple's sales in 2005. And while mos lysts think that iPod sales will continue to skyrocket for th couple of years, they also believe that the music player n will come back to earth at some point. "The Mac will creasingly important [to Apple's growth] in the last years decade," says Needham & Co. analyst Charles Wolf.

The reason is straightforward: On the whole, PCs are bigger than digital music. Right now, Apple dominates th ital music player market, which is expected to hit $12 bil 2009, with a share of more than 70%. But Apple has just the $75 billion home PC market. Each additional point market share that Apple gains would equal roughly $75 lion in sales. That's a big chunk for a $16 billion company Wu, an analyst at American Technology Research, think sales could grow 25% in 2007, vs. 10% for the broader in Beginning in 2007, says Wu, "I think the Mac business w



grow the iPod business."

Of course, not everyone agrees Apple can make that happen. Indeed, Apple shares have dropped 25% since mid-January on fears that the iPod wasn't lifting Mac sales, and that the "iPod halo effect" hasn't materialized. In fact, as Apple is converting from Macs that use IBM's PowerPC processors to ones with chips made by Intel Corp., its market share gains have stalled. Also contributing to the concerns are some well-publicized hacker attacks on the Mac, which have sullied its pristine reputation as a virus-free alternative to Windows. "I really don't think there has been much of a halo effect," says Roger L. Kay, president of

TENT CACHET Despite a price that's ice that of its PC rivals, the MacBook has a waiting list

ology consultant Endpoint Technologies Associates Inc. t of what they've done is reconvert the faithful."

vertheless, there are plenty of reasons to expect a Macin- enaissance. Currently, Apple is struggling to meet de- for its new MacBook Pro laptop despite a $1,900 price at is nearly twice that of garden-variety rivals. Apple- ers expect the company to launch lower-priced MacBooks ing months to compete for the lion's share of the market. ly next year, Adobe Systems Inc. will have converted its popular graphics and Web publishing software to run at top speed on the new Intel-based Macs, a critical event for Mac power users. "They should regain share in the back half of the year," says Smith Barney Citigroup analyst Richard Gardner.

Opening New Windows

APPLE HAS SOME WILD CARDS it can play to goose the Mac's market share, as well. While Apple won't comment, Needham's Wolf believes that the Intel-based Macs will be able to run Windows programs right along with Mac titles by yearend. That could entice hordes of disgruntled PC owners to give the Mac a shot, secure in the knowledge that they can continue using familiar programs. This prospect seems to resonate among younger buyers, where Apple's resurgence has been most pronounced. Earlier this year, Wolf surveyed 255 college students, and the number of Windows-compatible PC owners who said they would "definitely" buy a Mac if it had this capability jumped from 1.8% to 13.5%.

In the longer term, Apple could still try an oft-debated strategy: licensing its Mac software to other PC makers. Dell Inc. has already expressed an interest in stamping out Mac clones, much as it does with Windows-based PCs today. With more companies hawking Macs, Apple's market share could rise into double digits. "Multiple PC makers have expressed an interest. It's not just Dell," says Kay. Such a scenario could eat into Apple's own hardware sales. But it would boost margins by bringing in a royalty stream that could approach $1 billion per year, guesses Kay.

For the moment, Apple is plenty tied up in its transition to Intel and in creating the next headline-grabbing digital entertainment device. Each week the company is adding content to its online iTunes music and video store, everything from *The Daily Show* episodes to Walt Disney Co.'s *High School Musical*, a full-length movie. As a result, analysts expect more products aimed at the living room. Many also expect the company to unveil an Apple branded cell-phone-cum-iPod by yearend. All those pots on the fire could well help Apple continue to remake our entertainment diets. But if Apple manages to maintain the kind of stellar performance it delivered in 2005, the Mac will be a major reason why. ■

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Sun microsystems share

WELL BEING Tech can help the chances of finding big reserves

STRATEGIES: SCHLUMBERGER

Free-Flowing Technology

BY MARK MORRISON

#5 FOR A COMPANY IN SUCH an old, dirty business as providing oil-field services, Schlumberger Ltd. has made its mark in a decidedly newfangled way. The industry leader has maintained its position for most of its 80 years by being far and away the most technologically advanced player in the game. Maybe it's encoded in the company's DNA: The business started in a Paris office in 1920 based on Conrad Schlumberger's revolutionary idea of using electrical measurements to map subsurface rock bodies.

Today, its menu of services for Big Oil is broader than that of such peers as Halliburton Co. or Baker Hughes Inc. Schlumberger can do everything from sizing up the geology of a site to assisting directional drilling to extract oil, from managing information about reserves and production for super-majors such as Shell Oil Co. to cementing the holes on a completed well. With oil and gas prices at record levels and exploration budgets bulging, Schlumberger's revenues and profits are surging. Demand for its high-margin services has propelled the New York company into the No. 5 spot on the BusinessWeek 50 this year.

Credit is due in large part to Chief Executive Andrew Gould, who upon taking over in early 2003 righted Schlumberger's course after an ill-fated, multibillion-dollar foray in information-technology consulting. Investors have certainly welcomed Gould's sensible retre ment: The stock price tripled since his arrival.

Gould, a 30-year com vet who works in Paris, h simple plan: Exploit Sch berger's advantages in scale, breadth, and in try-leading technologies. Last year, the co ny's R&D budget was $506 milli substantially more than any of its competi according to brokerage A.G. Edwards "Schlumberger has the clear leadership pos and is very committed to maintaining that," analyst Poe Fratt. In November the compan the ribbon on a 53,000-square-foot addition Global Drilling Technology Center in Glouce shire, England, where 270 engineers vet p type drilling systems before they're deploy fields around the globe. Schlumberger can horizontal wells so far and with such accu Gould recently boasted, "we can hit a targe size of a tennis court from 10 miles away."

With easy-to-find oil scarce, Big Oil companies are looki expensive and risky exploration projects deeper in the sea Schlumberger technology can improve the chances that well find substantial oil or gas reserves. That's a big reason reve jumped 25% in 2005, to $14.3 billion. Late last year, for exa Norsk Hydro ASA, a Norwegian oil-and-gas producer, emp a Schlumberger sonic scanner that uses acoustics to help pr data on oil fields that previous technology wasn't able to Also working for ConocoPhillips in Alaska's North S Schlumberger's PeriScope system helped steer a 6,800-foo izontal well in a reservoir only eight feet thick.

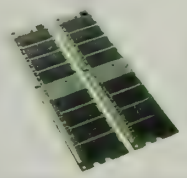
Many exploration and production companies are also re ing to older fields where the high price of oil justifies the Schlumberger's well-stimulation and information-manage processes. Shell, for one, just signed Schlumberger to a three contract to squeeze the last bits of oil left in long-forsaken all over Europe. The technology, which improves Shell's abi read seismic data, makes it possible for Shell to make bett cisions about stimulating old wells in places such as No Holland, and Scotland.

To be sure, if oil prices fall from their historical highs, Sch berger's technology will look less affordable to the energy

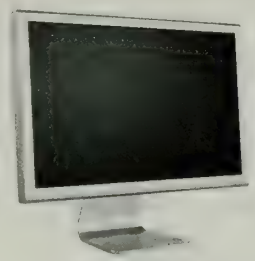
FOCUSED EXPERTISE Schlumberger keeps its lead in the oil patch with far a away the biggest outlays on R&D

panies. But Gould has said it'll take "several years" to repla day's tight supplies, many of which have been under explo since the last up-cycle in the 1970s. Gould's biggest pr nowadays is to find enough qualified engineers and other s workers to handle the increased workload. It's inevitable th other downturn will visit the energy sector, but with Gould helm, expect Schlumberger to keep doing what it knows b

OCEAN FCL FROM SINGAPORE



GUARANTEED SECOND DAY FROM SAN ANTONIO, PUERTO RICO



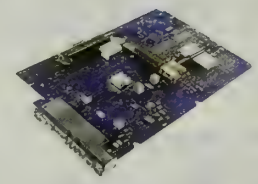
EXPEDITED AIR FREIGHT FROM SEOUL, SOUTH KOREA

FCL OCEAN SERVICES FROM TOKYO, JAPAN

DIRECT SHIP FROM SHENZHEN, CHINA

OVERNIGHT FROM MONTERREY MEXICO

OVERNIGHT FROM REDMOND, WA



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SMART CHOICE

STRATEGIES: GOLDMAN SACHS

White-Hot, and Streaking Ahead

BY JOSEPH WEBER

#15

GOLDMAN SACHS GROUP INC. HAS BEEN dazzling Wall Street with its take-no-prisoners advance lately. Its investment-banking, trading, and asset-management businesses are all white-hot. Their combined efforts led to a 24% gain in net income, to $5.6 billion in 2005, on a 45% rise in revenues, to $43.4 billion. As the 137-year-old firm blasts past peers, it seems nearly unstoppable.

Firing on all cylinders propelled Goldman to the No. 15 spot on the BusinessWeek 50, a huge leap from its 116th-place perch in our larger Standard & Poor's 500-stock index tally a year ago. Its stock jumped 23% in 2005, to about $128, and has since topped $150. Most analysts remain effusive. "The growth will accelerate this year," says CIBC World Markets' Meredith Whitney, who expects shares to reach $190. "You have a tremendous environment for [making] and for harvesting investments."

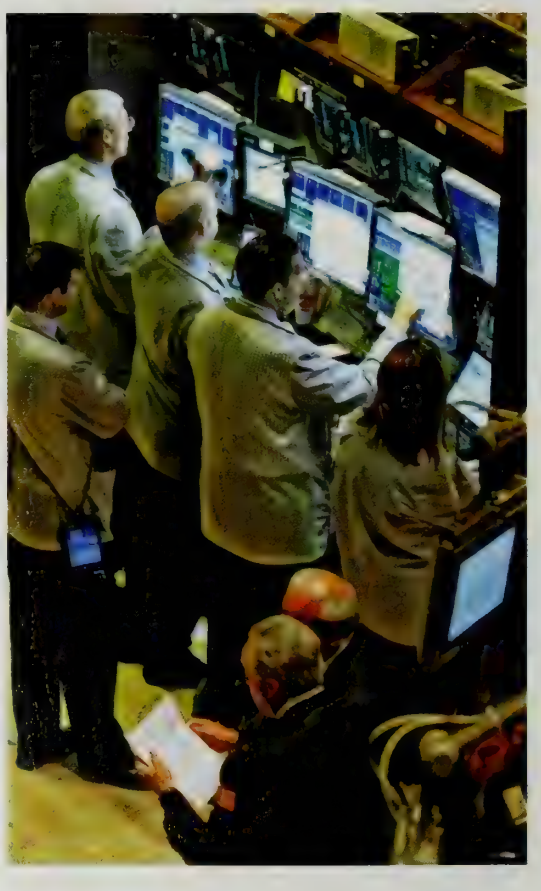
Not So Transparent

THE MOST POWERFUL engine at Goldman is one that roars mostly behind the scenes. Its trading and principal investments business, where commodities, fixed-income, and equities traders use proprietary strategies to play the markets, churned out $16.3 billion, or 66% of its revenues net of such expenses as interest. The business has made some savvy investments, taking stakes in U.S. power plants and other energy concerns while demand is hot. Globally, too, Goldman made smart bets: A $1.3 billion stake in Sumitomo Mitsui Financial Group Inc. bought in 2003 is worth more than $4 billion.

Having such a fat slice of its profits come from a business that stays largely mum about how it achieves its gains makes some analysts nervous. Goldman, according to CreditSights Ltd. analyst David H. Hendler, "is a high-performance race car, but we don't know exactly how the engine works." One oft-repeated line on Wall Street: The best way to invest in a hedge fund is to buy man stock.

Goldman's risk profile is going up in part because it's i ing more alongside its clients. This year, for example, it with clients Allianz and American Express Co. to provi lion's share of $3.8 billion plowed into the Industrial & mercial Bank of China. The firm will help the giant C bank upgrade technology and processes and then exp gain after it goes public in a mammoth initial public off

Just how much riskier is Goldman? Its "value at risk," a measure of how much money it could lose on any par trading day, jumped 15%, to $92 million, in the first q Standard & Poor's analyst Robert Hansen argues that as a of revenues, the amount at risk has declined as the revenue grown. He's not worried, since net revenue this year sho $29 billion, up 14%. CreditSights analyst Hendler frets, ho that "what goes up can come down." If market losses add warns, revenues will fall as well. Says Goldman Chief Fi Officer David A. Viniar: "We take risks commensurate w portunities that we see." The VAR number is the highest been, but not the highest it will be, he adds. "As the bu grows, we see more opportunities in more places."



NYSE Goldman was in on its Archipelago deal

If market bets do turn aga Goldman has other, albeit s profit engines. It ranked No. 1 la in mergers, playing advisory rol of the 10 biggest deals in the w helped Procter & Gamble Co. s Gillette in a $57.2 billion abroad, it midwifed acquisition as Gas Natural SDG's $51.2 takeover of another Spanish Endesa. In a controversial move advised both sides in the mer tween the New York Stock Ex and Archipelago Holdings. ment banking revenues hit thei est level in four years, at $3.7 And its asset-management weighed in with $4.8 billion in

As Goldman expands, its ris expand as well. And one of its areas of expertise is, of course aging risk. Now, Goldman's g challenge may simply be top own performance. ■

MATCHMAKER

In 2005, Goldm served as an adviser on 6 of the year's 10 biggest deals

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THE BUSINESSWEEK 50

STRATEGIES: HORTON AND LENNAR

More than One Way To Build a Home

BY PETER COY

#26

#42

WALL STREET DISDAINS THEM EQUALLY, but there are real differences between the two homebuilders in this year's BusinessWeek 50. D.R. Horton Inc. (No. 26) of Fort Worth is intensely focused on growth, vowing to double the number of homes it builds by 2010. Lennar Corp. (No. 42) of Miami intends to grow, too, but it's building a cash hoard that would allow it to buy land and smaller builders at fire-sale prices if the opportunity arises. Horton will be a superstar if its growth strategy pans out, while Lennar could come out ahead if there's a downturn.

It's easy to understand why investors stash Horton and Lennar into the same mental filing cabinet. They're both big builders that specialize in starter and first-step-up homes in the Sunbelt, with selling prices averaging about $300,000. By coincidence, even their revenues last fiscal year were twinned: around $14 billion for each, with Lennar edging out Horton. Fearing a housing slump, the market gives them roughly equal price-earnings ratios: around seven times last year's earnings. Only one sector of the Standard & Poor's 500-stock index has a lower trailing p-e: auto makers.

Growth Ethic

DESPITE THEIR SIMILARITIES, the differences between Horton and Lennar are telling. Horton, already No. 1 in homes sold, is aiming for close to 15% annual unit growth. The ethic is bred in the bone at Horton, which has had rising revenues and profits every quarter since it was founded by Chairman Donald Ray Horton in 1978. Donald J. Tomnitz, Horton's CEO, says he's expecting lots of demand from baby boomers, immigrants, and "echo boomers." But even if that demand doesn't materialize, the company aims to grow by grabbing business with aggressive incentives or, as a last resort, price cuts, says analyst Ivy L. Zelman of Credit Suisse Group. Says Zelman: "Horton is being accused by other builders of spiraling down the market." Horton responds that growth won't come at the cost of profitability.

In addition to being growth-hungry, Horton is decentralized. Each of its 77 markets in 26 states is run by a profit-center manager, who decides what to build and where. And crucially for a softer market, it's also probably the lowest-cost producer of entry-level houses, thanks in part to putting the screws suppliers, says analyst James F. Wilson of JMP Securities

Lennar has a more button-down, centralized style. Alt it's forecasting 13% unit growth this year, it stresses ret capital over steady growth. In a unique strategy to prev homebuilding units from overbuying land to feed constr growth, it has put land acquisition into a separate di that's rewarded for keeping costs low. It reduces capital by bringing in joint-venture partners, as it is doing in project planned for the former El Toro Marine Corps Air S in Irvine, Calif. And its balance sheet is among the clea the industry, with nearly $1 billion in cash and non-fin services debt at 33% of capital. That's plenty of mor vulture acquisitions in a softening market. A final diff comes in quality: Lennar, along with last year's BW50 m Pulte Homes Inc., scores highly in the annual J.D. Po Associates New-Home Builder Customer Satisfaction Horton has fared poorly, although Tomnitz says its mark cess proves customers are happy.

Differences in strategy don't seem to matter much to m vestors, who have tarred all builders as risky proposition frustrates both of the BW50 homebuilders. Horton exe argue that their track record of steady growth will be unb

BROWSING Horton mo home in Camarillo,

BOOMERS VS. BUST Horton is bettin on continued demand, while Lennar i well-positioned for a softer market

"Some people accuse us of being cocky, which, if you k we're not. We're very conservative people," says Tomnit Lennar, its executives concede that the market is soften see opportunities. Says Chief Financial Officer Bruce E. "If there's a slowdown, there is a unique opportunity to idate the industry." Adds Zelman: "The jury's out on wh prove to be the right formula." Take your pick. ■

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The World According To
TED

Serving Size about 1

At birth, the human body is about 78% liquid*. And I'm willing to bet the remaining 22% doesn't want to be swimming around in bubbles, caffeine and artificial sweetener.

* Percent Daily Values are based on a 2,000 calorie diet.

on the most complete and secure, ever-more-scalable network of the
T to help him introduce, market and distribute his healthy beverages.

The new at&t

ON THE MOVE FedEx plans a $150 million superhub in Guangzhou

STRATEGIES: FEDEX

Taking Off Like 'A Rocket Ship'

BY DEAN FOUST

#40

AS SOON AS MOTION COMPUTING INC. in Austin, Tex., receives an order for one of its $2,200 tablet PCs, workers at a supplier's factory in Kunshan, China, begin assembling the product. When they've finished, they individually box each order and hand them to a driver from FedEx Corp., who trucks it 50 miles to Shanghai, where it's loaded on a jet bound for Anchorage before a series of flights and truck rides finally puts the product into the customer's hands. Elapsed time: as little as five days. Motion's inventory costs? Nada. Zip. Zilch. "We have no inventory tied up in the process anywhere," marvels Scott Eckert, Motion's chief executive. "Frankly, our business is enabled by FedEx."

There are thousands of other Motion Computings that, without FedEx, would be crippled by warehouse and inventory costs. That value proposition has made the Memphis shipping giant an indispensable partner for companies whose products are made in China. In the past two years, the volume of goods that FedEx has shipped over its vast international network has soared 40%, with much of the growth from Asia. FedEx earnings leapt 21% last year, and its stock price has more than doubled since 2003, landing FedEx the No. 40 spot on the BusinessWeek 50. "FedEx has a rocket ship," says D Ortwerth, analyst at St. brokerage Edward Jones.

That FedEx has becom preferred carrier out of Ch no accident. As far back as the 1980s, I founder and CEO Frederick W. Smith predicte Asia would become an economic powerhou 1989 he shelled out $895 million to buy Tig ternational Inc., a struggling cargo haule nonetheless had assets Smith coveted: flying into most major Asian airports and a manag team with a deep knowledge of the Pacific Wall Street roundly panned the move— Asian economies were unstable at the time— was prescient, giving FedEx a 10-year jump vals. "Analysts didn't like it," chuckles M Ducker, executive vice-president for interna in FedEx' express unit. "But like Wayne G used to say, we saw the puck and skated towa

These days, FedEx operates 120 flights v to and from Asia, including 26 out of China As a result, FedEx now controls 39% of the (to-U.S. air express market, vs. 32% for United Parcel S Inc. and 27% for DHL International, according to Satish president of SJ Consulting Group Inc. in Pittsburgh.

Now Smith is doubling his bets on China. FedEx pl close its Asian hub in the Philippines by 2008 in favor of $150 million superhub in Guangzhou, a city in the heart of China's fastest-growing manufacturing districts. A 2008, FedEx will take delivery of the first of up to 20 of A A380 cargo haulers, birds so massive that they hold tw load of the Boeing MD-11. The A380 can fly nonstop fro to FedEx' U.S. hubs. Here again, Smith was ahead of the By being the first American customer, he not only beat the punch but got to contribute to the configuration A380, too. "They played a pivotal role in the design," say McArtor, chairman of Airbus North America Holdings I a former FedEx executive.

FedEx' ambitions in China may extend beyond expo January, it spent $400 million to buy out its 50-50 delive ner in China, Datian Group. That gives FedEx full contr Datian's truck fleet and its 89 distribution hubs. Some a such as Morgan Stanley's James Valentine, believe that t chase is a step toward FedEx domestic service between largest cities, at least for large business customers. Som der, though, if China is ready for that, given the shabby its highways. "[FedEx] could run up against infrast problems," warns Ortwerth. Smith isn't worried. He' right about China before. ■

WHAT GREAT WALL? FedEx is the preferred carrier out of China, with flying rights into most Asian airport

Tomorrow's water forecast calls for clear, with a good chance for more of the same.

The world's thirst for fresh water is growing faster than nature can provide. It's quickly becoming one of the key resource issues of the 21st century. For two decades, Dow has been the leader in providing one of the most promising solutions. Using FILMTEC™ reverse osmosis membrane technology from Dow, communities in water-stressed areas have access to clean, fresh, affordable water from seawater desalination and from lakes and rivers that were previously unsuitable due to pollution. The world can have quality water for life. All we need is the right chemistry.

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INVESTING BY DAVID HENRY

TOP Prospects

ARE THE STOCKS OF THE BusinessWeek 50 as interesting as the companies? In many cases, yes—at least for courageous investors. BW50 company stocks tend to be unusually volatile and richly priced.

Shares of NVIDIA Corp., the factoryless maker of high-performance computer graphics chips, for example, are among the most volatile in the Standard & Poor's 500-stock index. And the price-earnings ratio of the BW50 is 18.6, two points more than the index. Shares of Yahoo! Inc., another BW50 member, recently traded at a massive 60 times expected 2006 earnings, even though the stock had tumbled 20% in the preceding two months.

High valuations and volatility are no surprise among the ranks of the BW50. Many of the companies are well known, widely held, and carry a median market capitalization of $33 billion, nearly three times the median S&P 500 company. Their potential growth attracts a lot of attention. Stock analysts surveyed by Thomson First Call expect earnings per share of the median BW50 company to grow annually the next five years by 15%, vs. 11% for the S&P 500.

THRILL OF THE CHASE The distinguishi characteristics of the BW50 stocks are th volatility and high valuations

Dividends Yielding Clues

STILL, THE BW50 is worth mining for investing ideas. Consider Prudential Financial Inc., the insurance and investment giant. Its stock is moderately volatile and sells at a below-market p-e of 14. Analysts figure earnings will grow 13% annually over the next three to five years. Pru pays a dividend yield of 1% and has enough resources to continue buying back shares even after reducing its share count by a sizable 6% last year.

For investors who abhor stock gyrations, rail carrier Burlington Northern Santa Fe Corp. is worth a closer look. The stock is less volatile than the market as a whole, and the company is raking in cash as it packs its lines with railcars loaded because of the growing economy. It is handing a good cl that cash back to investors through dividends and sha backs. And while Texas Instruments Inc.'s high volatilit put off nervous investors, its earnings per share are exp grow an exceptional 20% annually over the next thre years. Better yet, the stock has been selling for a relative est 20 times earnings recently.

To find potential winners, we screened the shares BW50 in several ways using data from research divis Standard & Poor's. First, we pruned the list to 36 by in only those rated four- and five-star buys by S&P's Eq search Services. Based on S&P's data and analysis, thes

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WITH COLOR ACCESS CONTROL

HP Color LaserJet 3800n

- Network-ready, color laser printer
- Print speed: up to 22 ppm black and color
- Resolution: 600 x 600 dpi with HP ImageREt 3600
- Duty cycle: 65,000 pages per month
- USB 2.0 and Ethernet ports

$999 PRINTER CDW 844586
-100 INSTANT SAVINGS
$899

WITH COLOR ACCESS CONTROL

HP Color LaserJet 4700n

- Network-ready, workgroup color laser printer
- Print speed: up to 31 ppm black and color
- Resolution: 600 x 600 dpi with HP ImageREt 3600
- Duty cycle: 85,000 pages per month
- Parallel, USB 2.0 and Ethernet ports

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also sifted the stocks ac-
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no real way to know the
that a stock will lose
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rket, you want a stock
beta of 1 or less.
12 of the BW50 stocks
t test, most of those just
The betas we used were
n weekly price changes
past two years as com-
y Capital IQ, an S&P re-
service for institutional
rs, investment bankers,
vate equity funds. (Wall
ften uses five-year peri-
measure beta, but we
ed the period after find-
t the five-year measure
d stocks of energy pro-
as exceptionally low
parently because they
udged until the price of
d in 2004.) For moder-
, we found nine stocks
tas from 1 to 1.2. Then we flagged as higher risks 12
vith betas of 1.6 and greater.

PORTFOLIO PICKS
From the BusinessWeek 50

LOWER RISK

COMPANY SYMBOL	PRICE	BETA	SHAREHOLDER PAYOUT %*
Microsoft (MSFT)	26.87	0.90	5.90
Burlington Northern (BNI)	78.64	0.90	2.41
JPMorgan Chase (JPM)	41.14	0.97	5.26

MODERATE RISK

COMPANY SYMBOL	PRICE	BETA	PEG**
Weatherford Intl. (WFT)	43.12	1.09	0.79
Goldman Sachs (GS)	141.29	1.09	0.88
Merrill Lynch (MER)	77.21	1.15	1.06
Halliburton (HAL)	68.00	1.18	1.08
Prudential Financial (PRU)	77.04	1.19	1.07

HIGHER RISK

COMPANY SYMBOL	PRICE	BETA	GROWTH RATE ***
Coach (COH)	35.72	1.70	20.00
Texas Instruments (TXN)	29.85	1.84	20.00
Yahoo! (YHOO)	32.06	1.90	25.65
NVIDIA (NVDA)	47.13	3.14	20.00

* Current dividend yield plus percentage reduction in shares outstanding past four quarters ** Ratio of price-earnings ratio to projected growth rate *** Growth rate in earnings per share projected by stock analysts
Data as of Feb. 28 **Data:** Standard & Poor's Compustat, Capital IQ, Equity Research Services

ng the Wealth

HEN WE REFINED each list even further. We hunted
ks with low prices compared with expected earnings.
v companies in the BW50 have the safety margin of a
p ratio. So we looked to dividend yields—one of the
iable components of future returns on stocks—as tal-
S&P's Compustat. Only six BW50 companies yield
an the 1.9% of the S&P 500. A number, however, have
urning a lot of money to shareholders by buying back
o winnow out buybacks made by companies just to
he shares they issue for employee stock options, we
npanies credit for the percentage by which they actu-
ced their numbers of shares outstanding. And then
d that to their dividend yield and came up with what
shareholder payout. We found 17 of the BW50 with
of more than 2%.
scovered three stocks with low volatility and high pay-
th a further look, including Burlington Northern. Another company, Microsoft Corp., reduced its shares outstanding by 4.5% last year and is yielding 1.4%. Analysts expect earnings to grow 12% annually. The third, banking giant JPMorgan Chase & Co., is yielding 3.3% and trading at a relatively low 12 times expected 2006 earnings.

Investors willing to accept greater stock gyrations have more opportunities. Among the stocks with moderate risk to consider, several now offer the prospect of growth at a reasonable price. Five, including Prudential Financial and Goldman Sachs & Co., traded as of Feb. 28 at price-earnings ratios of less than 1.1 times their expected earnings growth—the so-called p-e to growth, or PEG, ratio. Oilfield service company Weatherford International Ltd. has among the highest earnings-per-share growth forecasts of any of the BW50 at 25%. Another oilfield company, Halliburton Co., is expected to increase earnings 16% annually as demand for energy stays strong around the world.

The most volatile stocks include some with exceptionally high expected growth rates. They may not all be worth the extra risk of owning them, but four have projected earnings per share growth of 20% or more. Chipmaker Texas Instruments has the most going for it. Its price-earnings ratio of 20 is below its historical average and no more than the stock's growth rate. Buybacks cut the company's share count by 7% last year. NVIDIA, too, has a p-e roughly equal to its 20% growth rate. But the stock has run up 115% from April through February, vs. a 20% gain at Texas Instruments in the same period.

The contrast between NVIDIA and Texas Instrument shares shows that quantitative filters can only guide investors so far. Buyers have to look around to flush out the rest of the story. With so many stocks to choose from and so little time, the BW50 is a good place to start. ■

BusinessWeek weekend For more on the stock market and some sectors that may be worth investing in, watch *BusinessWeek Weekend*. Check your local TV listings or go to businessweekweekend.com to view this and other stories from our weekly TV program.

The Ranking

They're not all in energy and health care. How companies of every stripe soared even in a climate of thin margins and cutthroat competition

APPLE COMPUTER INC.

»ALL THOSE LITTLE white earbuds are a bona fide cultural phenomenon —and serious business for Apple. Booming sales of its iPod music players have propelled the Cupertino (Calif.) icon to the top of our list of the best corporate performers. Apple shows few signs of slowing down. Of the 42 million iPods sold since the line was introduced five years ago, 32 million were sold in 2005, including 14 million in a killer Christmas quarter. Apple's profits leapt 216% in 2005 on a 66% jump in sales. Investors are still bullish, not only for what Steve Jobs has done, but also for what lies ahead. Jobs, soon to be the biggest shareholder in Walt Disney Co. thanks to its recent purchase of his Pixar Animation Studios, has inked landmark deals with TV studios and other Old Media powers. If Apple can extend its portable music dominance into the living room, its remarkable recovery might have far to run.

INDUSTRY
Technology Hardware & Equipment
SALES
$16.2 billion
NET INCOME
$1.6 billion

STEVEN P. JOBS, 51
CEO since 1997

/ C. SCOCK, 57
nce 1999

POINT

RY
ed Health Care

llion
COME
lion

2

POINT IS of at there is life megamerger. In late 2004 of um of two giants based alifornia and an Wellpoint is n's biggest surer, with 34 members. it snapped ork-based ce, along all n health point ders seem to er is better, p the stock year. Indianapolis, any is to sign up s 2 million bers under are drug n 2006. eaching uninsured riced

EDWIN M. "MAC" CRAWFORD, 57
CEO since 1998

CAREMARK RX INC.

INDUSTRY
Health-Care Services
SALES
$33.0 billion
NET INCOME
$932 million

3

» IN A PILL-POPPING nation, designing prescription plans and processing pharmacy claims is one lucrative business. Few know better than pharmacy benefits manager Caremark Rx, which helps companies, insurers, and government agencies put together drug coverage for employees. The Nashville company saw strong growth in its business filling prescriptions through the mail. Profits leapt 55%, to $932 million, on sales of $33 billion, up 28%. And Caremark, along with rivals, is poised to cash in again. The Medicare drug benefit is expected to boost spending on drugs by as much as $15 billion.

DR. WILLIAM W. MCGUIRE, 57
CEO since 1991

UNITEDHEALTH GROUP INC.

INDUSTRY
Managed Health Care
SALES
$45.4 billion
NET INCOME
$3.3 billion

4

» UNITEDHEALTH Group already serves an astonishing 65 million Americans with its health plans and other services. Now a push into serving the elderly could make it the biggest provider in Medicare's new prescription program in 2006. Its formula for success over the past 15 years: maintain a diverse mix of businesses, and make smart acquisitions. Even if gains from employer-sponsored plans slow, UnitedHealth's push into faster-growing niches such as discount health-care cards may boost profits. Earnings for the Minnetonka (Minn.) company are expected to jump about $1 billion, to $4 billion, in 2006.

ANDREW GOULD, 59
CEO since 2003

SCHLUMBERGER LTD.

INDUSTRY
Energy Services
SALES
$14.3 billion
NET INCOME
$2.2 billion

5

» WITH THE PRICE OF oil near historic highs, energy companies are willing to invest big money to find new fields and rework old ones. No outfit benefits more than Schlumberger, the leading oil services provider. The New York-based company was global long before the concept was in vogue, and now has 58,000 employees of 140-plus nationalities working in more than 80 countries. That footprint, and state-of-the-art technology, is key as new oil is found in increasingly deep water and remote areas. It may not be glamorous work, but shares have tripled since 2002, and demand for Schlumberger's expertise is steady.

RAY R. IRANI, 71
CEO since 1990

6

OCCIDENTAL PETROLEUM CORP.

» BACK IN THE LATE 1990s, when oil prices were low, Occidental's CEO placed two big bets, spending just over $7 billion to snap up aging oil fields in Texas and California. Today, with near-record prices for crude, those wells have turned Oxy into the world's most profitable oil company. Last year the Los Angeles outfit managed an impressive $20-per-barrel profit, tops in the industry, according to Deutsche Bank Securities Inc. Lebanese-born Irani is still on the hunt. Last year he pounced on Tulsa's Vintage Petroleum for $3.8 billion and built up the biggest acreage position in Libya, newly open to American companies after years of sanctions. That nation was the site of Oxy's largest discoveries back in the day when industry legend Armand Hammer ruled the roost. Irani figures that new projects and acquisitions could boost production to nearly 1 million barrels a day by 2010, a sizable jump from the current 590,000. No doubt old man Hammer would be proud of the way his hand-picked successor is managing things.

INDUSTRY
Energy
SALES
$15.2 billion
NET INCOME
$5.3 billion

THE BUSINESSWEEK 50

PAUL E. JACOBS, 43
CEO since 2005

QUALCOMM INC.

INDUSTRY
Communications Equipment
SALES
$6 billion
NET INCOME
$2.3 billion

8

»RAISING ITS earnings expectations has become a regular event at Qualcomm. The San Diego-based cell-phone chipmaker has hiked its projections three times in the last year on the strength of its hot-selling CDMA digital wireless technology. The industry leader in the U.S., Qualcomm's revenues have grown nearly fivefold since 2002. Now it's making big inroads into Europe, China, and India, where its wireless technology trailed behind the more widely deployed GSM. Also, it's gearing up for the U.S. launch later this year of MediaFLO, a TV-over-the-phone service that it hopes will drive chip sales.

KEVIN SHARER, 58
CEO since 2000

AMGEN INC.

INDUSTRY
Pharmaceuticals & Biotech
SALES
$12.4 billion
NET INCOME
$3.7 billion

9

»AMGEN MAY BE ONE of the grandpas of the biotech industry, but it's looking as sprightly as ever. Profits jumped 55% last year on strong sales of its flagship drugs to treat anemia and to prevent chemotherapy-induced infections. Unlike many of its Big Pharma cousins, the California company is adept at balancing its investments in marketing and research, allowing it to boost sales of existing drugs while developing promising new treatments, such as those for colon cancer and osteoporosis. Will Amgen's constitution stay strong? Analysts predict a 15% annual rate of growth in earnings over the next five years.

RONALD A. WILLIAMS, 56
CEO since 2006

AETNA INC.

INDUSTRY
Managed Health Care
SALES
$22.5 billion
NET INCOME
$1.6 billion

10

»THOUGH NEW TO the top job, Williams has been a key player in the much lauded turnaround at Aetna. The industry veteran worked alongside former CEO Jack Rowe to tighten up operations, winnow membership rolls, improve program offerings, and return the Hartford health insurer to profitability. The result: total returns of 385% to shareholders over the past three years. Now Williams is looking to build on Aetna's innovations in areas like consumer-driven health care and disease management programs. In a fast-consolidating industry, though, the first big move by Aetna's new boss may be a significant acquisition or merger.

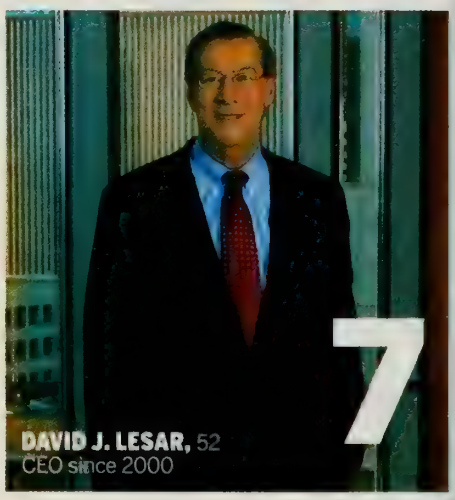
ROBERT A. NIBLOCK, 4
CEO since 20

LOWE'S C

INDUSTRY
Specialty reta
SALES
$43.2 billion
NET INCOME
$2.8 billion

11

»AH, THE SW smell of untap markets. Whil archrival Hom Inc. is pulling the pace of ne openings as it approaches saturation in t market, No. 2 improvement Lowe's is still growth mode. Mooresville (I company ope first store in N Hampshire in and added a t 150 stores ov bright, airy, a female-friend and an establ reputation fo customer ser luring shoppe Home Depot. Lowe's stock continues to l darling of Wal It's up more t 210% over th five years.



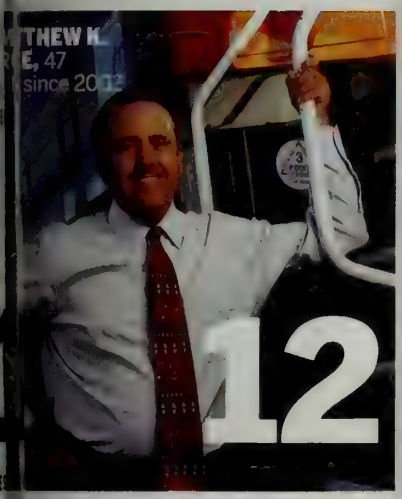
DAVID J. LESAR, 52
CEO since 2000

7

HALLIBURTON CO.

INDUSTRY
Energy Services
SALES
$21 billion
NET INCOME
$2.4 billion

»JUST A COUPLE of years ago, Dave Lesar had the corner office job no one in his right mind would want. As CEO of Halliburton, the huge oil-services construction-contractor firm, Lesar faced an energy slump depressing his core oil-and-gas services business, billions in unsettled asbestos liabilities, and political hot potatoes ranging from previous CEO Dick Cheney's compensation to controversial no-bid contracts in Iraq. Deal with them he did. The former Arthur Andersen accountant certainly benefited from sky-high energy prices, which have lifted all ships in the sector. Still, Lesar was able to put Halliburton's asbestos issue to rest by paying more than $4 billion into a trust intended to compensate more than 400,000 claims. He has also begun the process of separating Halliburton from its chronically controversial Kellogg Brown & Root construction unit. The first step is a probable IPO for 20% of KBR's shares, expected later this year. Halliburton stock, which traded in the single digits in early 2002, recently hit $70. And the outlook is bright, as long as global economic growth doesn't peter out.



12

U LINGTON NORTHERN A TA FE CORP.

INDUSTRY
Railroads
SALES
$13 billion
NET INCOME
$1.5 billion

E'S ONE good thing about being a ro even as manufacturing, one of the to 's historic customer bases, moves : Imported products have to get to ers, too. Burlington n Santa Fe is one of two s making its debut on BV 0 list. Volume is one so Burlington, whose 0 niles of track lace the e two-thirds of the U.S., record shipments in 5, th double-digit growth in consumer rm products, lumber, and other ities. Leverage is another reason. Like er transportation outfit, the Fort based company has been hit by all-time- gy costs. But CEO Rose was able to g all the extra expense to customers gh surcharge. As a result, profits nearly to $1.5 billion. It doesn't look like n is about to lose the head of steam it up: Industry analysts recently revised eir profit forecasts for 2006 and 2007. ad is also bumping up its capital to meet higher demand.

EDWARD J. ZANDER, 59
CEO since 2004

TERRY S. SEMEL, 63
CEO since 2001

HENRY M. PAULSON JR., 60
CEO since 1999

RICHARD S. FULD JR., 59
CEO since 1993

13

MOTOROLA INC.

INDUSTRY
Communications Equipment
SALES
$36.8 billion
NET INCOME
$4.6 billion

» **THERE'S NO** secret to the spark behind Motorola's sizzling success: It's all about "RAZR and more RAZRs," says CEO Zander. Fueled by the RAZR, the company shipped 146 million phones in 2005, up 40% over 2004. The growth has helped Motorola boost global market share from 15.4% at the end of '04 to 19%, edging closer to industry leader Nokia Corp. To keep RAZR sales brisk, Motorola has introduced its phone in a variety of colors—black, gunmetal gray, magenta, and blue. At the same time, several new phones are hitting the market, including the SLVR and Q, svelte cousins of the RAZR. Zander hopes they'll have the same sharp edge.

14

YAHOO! INC.

INDUSTRY
Internet Software & Services
SALES
$5.3 billion
NET INCOME
$1.9 billion

» **YAHOO! BOASTS** diverse Internet businesses, from search and banner ads to subscription services like fantasy sports leagues. There were more than 400 million visitors in the fourth quarter of '05, up 25% from a year earlier. The number of pages viewed rose 23%. But although Yahoo's top line grew 47% in '05, that was less than half the pace of Google Inc.'s growth. Yahoo is losing search market share to Google while trying to hatch a media strategy. Its stock price has been flat since late '04, even as Google's shares leapt 300%. All reasons why maintaining its position as Internet world-beater may not be so easy.

15

GOLDMAN SACHS GROUP INC.

INDUSTRY
Diversified Financials
SALES
$43.4 billion
NET INCOME
$5.6 billion

» **GOLDMAN SACHS** Group has a killer combination of businesses. It has a tour de force in its trading and investment business, which churned out $6.2 billion in pretax income in 2005. And Goldman's investment banking advisory division, which pumped out $413 million, is one of the strongest in the world. With dealmaking expected to stay robust and Goldman's traders thriving in commodities, fixed income, and equities alike, analysts are bullish on the company. But as Goldman and its clients invest more often together, its risk profile may rise. So far, though, shareholders don't seem to mind.

16

LEHMAN BROTHERS HOLDINGS INC.

INDUSTRY
Diversified Financials
SALES
$32.4 billion
NET INCOME
$3.3 billion

» **LEHMAN BROTHERS** is no longer just a bond issuance and trading shop. After expanding its asset management business and poaching talent from competitors, the New York investment bank enjoys the revenue mix and client roster of Wall Street's elite. While Lehman's bond business has thrived, CEO Fuld has also steered the bank to a No. 3 ranking in global mergers and acquisitions. Lehman's profits have more than tripled since 2002. Its stock price is up 132% over the same period. And for the third straight year, the firm's U.S. equity research staff earned top honors in *Institutional Investor* magazine's annual survey.

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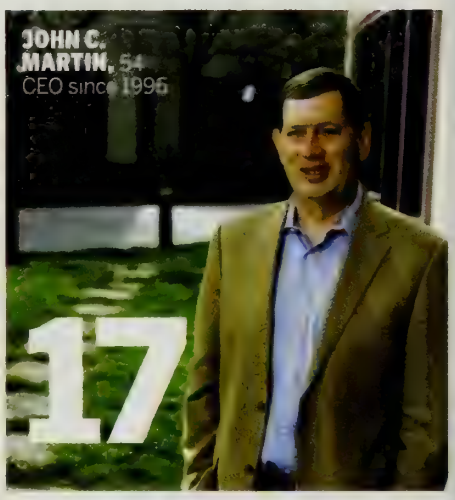
LEXUS



JOHN C. MARTIN, 54
CEO since 1996

17 GILEAD SCIENCES INC.

INDUSTRY Pharmaceuticals & Biotech
SALES $2 billion
NET INCOME $814 million

» **ONCE, TAMIFLU** was simply the icing on the cake for Gilead Sciences, a fast-growing biotech that's a leader in developing HIV drugs. But fears of an avian flu pandemic have led governments to begin stockpiling the antiflu drug, which Gilead invented and later licensed to Roche Holdings Ltd. Largely owing to Tamiflu, Gilead's royalty revenues skyrocketed 166%, to $219 million, in 2005. The Foster City (Calif.) company is also trying to cement its No.1 position in its core HIV drug business. Strong sales there helped push overall revenues up 53%, to $2 billion. Profits jumped 81%, to $814 million. In the second quarter, Gilead plans to seek approval from the U.S. Food & Drug Administration for the first-ever regimen to treat HIV that would pack three drugs into one pill. That project, which Gilead is developing with Bristol-Myers Squibb Co., could hit the market by the end of the year. Analysts are so optimistic that Gilead can maintain its leadership in the antiviral market that they're predicting the company's earnings will grow 19% a year for the next five years.

TIMOTHY L. MAIN, 48
CEO since 2000

18 JABIL CIRCUIT INC.

INDUSTRY Technology Hardware
SALES $8.1 billion
NET INCOME $253 million

» **JABIL HAS BEEN A** big beneficiary of the outsourcing boom. From its humble start in the mid-1960s assembling circuit boards for electronics companies around Detroit, Jabil has grown into a leading contract manufacturer, employing roughly 50,000 workers in 19 countries. Since the tech bust in 2001, the St. Petersburg company has been on a major push to diversify beyond consumer electronics through acquisitions. Last year it bought the manufacturing operations of Varian, a maker of electronics for the aerospace and medical industries. The strategy is paying off: Profits soared 40% in 2005, to $253 million.

BRADBURY H. ANDERSON, 55
CEO since 2002

19 BEST BUY CO.

INDUSTRY Specialty Retailing
SALES $29.4 billion
NET INCOME $1 billion

» **THE NATION'S** No. 1 consumer-electronics chain has ridden exploding consumer demand for digital TVs, camcorders, and cameras to a spot on the BusinessWeek 50 list. Investors have certainly enjoyed the run: Shareholder return over that three-year period was 184.1%. This year won't be a slam dunk: Resurgent No. 2 Circuit City Stores, as well as Wal-Mart Stores, are aggressively gunning for Best Buy's business. To stay ahead, the Minneapolis company is stocking more upscale products and moving into new high-margin businesses such as Geek Squad, its in-home computer troubleshooting service.

JOSEPH M. TUCCI, 58
CEO since 2001

20 EMC CORP.

INDUSTRY Technology Hardware
SALES $9.7 billion
NET INCOME $1.1 billion

» **CREDIT TUCCI WITH** one of the most remarkable turnarounds in tech history. The new EMC is no longer just about storage hardware. Thanks to $4 billion worth of acquisitions over the past three years, the Hopkinton (Mass.) company's portfolio now includes document management, computer virtualization, and tech systems management. The shift toward software, with its higher margins, is driving profit growth: This year, Pacific Crest Securities expects EMC to boost net income by 30%, to $1.8 billion. Tucci, who has a $7.4 billion war chest, is set to continue his diversification drive.

CHAD C. DEATON, 53
CEO since 20

21 BAKER HUGHES I

INDUSTRY Energy Equipm Services
SALES $7.2 billion
NET INCOME $874 million

» **ECCENTRIC** billionaire Hov Hughes is long but the Houste company that his first divide check is still d away. Earning 66% last year Baker Hughes is a leading su of drill bits, we logging tools, other equipme finding and pr oil and gas. Re have been buc a ramp-up in spending by o companies. W eight technolc centers aroun globe and ove engineers, Ba Hughes contir search for way keep profits p even if oil pric New products generated abc a quarter of la year's sales.

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Implementation times are dependent upon a number of factors and may vary significantly. Referenced customer implementation times were from initial software installation to project go-live with real business data, and the implementations were for unmodified software.

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THE BUSINESSWEEK 50

JOHN T. CHAMBERS, 56
CEO since 1995

CISCO SYSTEMS INC.

INDUSTRY
Technology Hardware & Equipment
SALES
$25.9 billion
NET INCOME
$5.6 billion

JIM L. DONALD, 51
CEO since 2005

STARBUCKS CORP.

INDUSTRY
Hotels, Restaurants, & Leisure
SALES
$6.7 billion
NET INCOME
$524 million

PAUL S. OTELLINI, 55
CEO since 2005

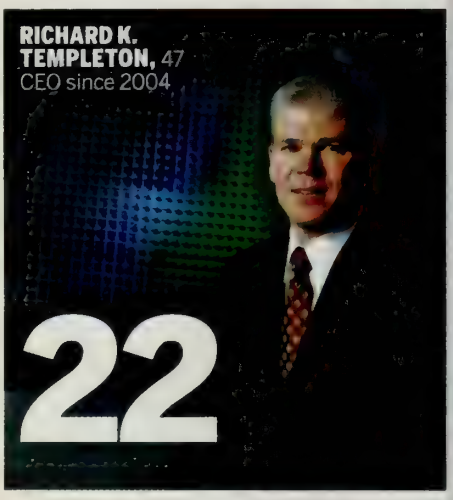
INTEL CORP.

INDUSTRY
Semiconductors
SALES
$38.8 billion
NET INCOME
$8.7 billion

DONALD J. TOMNITZ, 5
CEO since 19

D.R. HORT INC.

INDUSTRY
Homebuildin
SALES
$14.2 billion
NET INCOME
$1.5 billion



RICHARD K. TEMPLETON, 47
CEO since 2004

22 TEXAS INSTRUMENTS

INDUSTRY
Semiconductors
SALES
$13.4 billion
NET INCOME
$2.3 billion

IT'S HARD NOT to love Texas Instruments these days. Nokia Corp. and other cell-phone makers, experiencing explosive growth in both established and developing markets, are buying its digital and analog chipsets in ever-increasing numbers. TI's profits jumped 25% in 2005, and gross margins rose to 17.4%, compared with 14.8% a year ago. There's even more room for the company to grow now, thanks to CEO Templeton's plans to branch out into consumer electronics, with TI chips going into new gizmos such as the Slingbox streaming media server and giant TVs with digital-light-processing, or DLP, chips. Plus, the sale of the company's Sensors & Control segment to Bain Capital should plop some $3 billion into TI's coffers this year, which could go toward an acquisition or be used to continue its share buybacks. But after a long stretch of red-hot sales, analysts predict that TI's revenue growth will slow to a leisurely 3.1% in 2006, or $13.8 billion, before surging again in 2007. With demand running ahead of Wall Street's expectations, though, those predictions may be conservative.

23

CISCO HAS LONG been one of the most admired tech companies. The San Jose (Calif.) outfit has posted solid, if not spectacular, sales growth in recent years as it maintained its dominance in corporate networking gear and moved into related emerging areas such as wireless home routers, Net-based phones, and security software. But Cisco really started getting love from investors after it broke its strategy mold by acquiring 55-year-old set-top box maker Scientific-Atlanta Inc. in November. The deal could crimp margins in the short term, but it may give Cisco a leading role in wiring the digital homes of the future.

24

ONGOING DEMAND for coffee-based drinks and scrupulous cost containment kept Starbucks growing in fiscal 2005. The Seattle company has made moves into music sales and film production, but what's paying the bills is a continued laser-like focus on speeding up transactions, growing abroad, and finding niche markets in the U.S., such as drive-throughs and rural locations. Despite the threat of saturation in North American markets, the thirst for Starbucks apparently remains un-quenchable: The company has realized 14 consecutive years of comparable-store sales growth of 5% or more.

25

INVESTORS spanked Intel hard a year ago when factory snafus and other execution missteps tripped up the chipmaking titan. Intel roared back in 2005's second half, thanks to near-complete dominance of the notebook PC segment. Intel's revenues rose 13% for the year and net income jumped 15%. But rival Advanced Micro Devices continues to steal share in the lucrative server-chip segment. Analysts predict that Intel's earnings will tumble 26% this year as AMD continues to win business one chip at a time. Intel execs say a more competitive slate rolling out in the second half of 2006 will turn the tide.

2

REVENUE profit have ris every quarte D.R. Horton's founding in 1 execs at the F Worth compa confident of their target o 100,000 hom in 2010, dout industry-lead of 2005. "Th skeptics are wrong," says Tomnitz. "Th five years wil easier than t 28." If housin continues to Horton's emp efficiency an wringing con from supplie help it under builders. It al its strongest sheet ever. O 28% of last y unsold land homes was i California.

change + hp

ght idea in storage.

ce, a leader in lighting electronics, watched its data storage costs grow along business. Advance turned to HP to reverse the trend. With HP StorageWorks, ce is now able to consolidate its data, keeping critical information online for access while constantly moving older data to more cost-effective storage devices has reduced the time needed to manage the storage network from day to and clearly illuminated the path to change. hp.com/go/storageconsolidation

f change: HP StorageWorks SAN, Disk Array, Tape Library

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Based on NAV	12.21%	8.28%	13.92%	14.75%
Based on Market Price	12.53%	8.37%	13.87%	14.68%

Total returns are calculated quarterly using the daily 4:00 p.m. net asset value (NAV). Distributions, if any, are assumed to be reinvested back into the fund on the pay date at the NAV on that date. Performance data quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than quoted. The investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, are subject to market volatility. They may be worth more or less than their original cost. MDY shares are bought and sold at market price (not NAV) and are not individually redeemed from the fund. Brokerage commissions will reduce returns. To obtain most recent month-end performance, please call 1-800-843-2639 or visit www.MidCapSPDR.com.

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MID000101

LL A. "MILLER
ce 2001

JAMES DIMON, 50
CEO since 2006

E. STANLEY O'NEAL, 54
CEO since 2002

WILLIAM R. KLESSE, 59
CEO since 2006

ONAL ELL O INC.
RY
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OME
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JPMORGAN CHASE & CO.

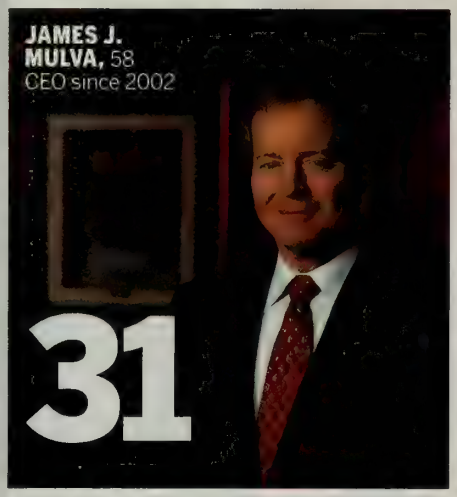
INDUSTRY
Diversified Financials
SALES
$79.9 billion
NET INCOME
$8.5 billion

MERRILL LYNCH & CO.

INDUSTRY
Diversified Financials
SALES
$47.8 billion
NET INCOME
$5.1 billion

VALERO ENERGY CORP.

INDUSTRY
Energy
SALES
$81.4 billion
NET INCOME
$3.6 billion



JAMES J. MULVA, 58
CEO since 2002

27

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28

» A HEALTHY increase in investment banking fees has plumped up the bottom line at JPMorgan Chase. But this New York bank's story is still about potential. Can Dimon, who became CEO on Jan. 1, six months ahead of schedule, complete the integration of Bank One and set a new course for growth? In the near term he'll have to deal with losses in the credit-card business and volatile trading revenues. For now, Wall Street has faith that Dimon's business acumen and strict attention to cutting costs will propel growth. Some observers expect a big deal by the end of the year: That would do the trick.

29

» MERRILL LYNCH has got its mojo back. Once slowed by bloated costs, the firm is building a presence in everything from wealth management advice to energy trading and private equity. Merrill's global markets and investment banking net revenues rose 25% in 2005. Under O'Neal, Merrill's net profits have tripled, to $5 billion, and its stock price has risen 47% since 2002. It will book an aftertax gain of about $1 billion in exchange for combining its asset management business with BlackRock Inc. O'Neal isn't signaling his next move, but Street talk is that he may try to buy a regional retail broker or bank.

30

» AS GROWTH IN demand—together with the dual punch of Hurricanes Katrina and Rita—strained U.S. refining capacity again in 2005, the perennial poor cousins of the energy sector enjoyed record margins. No company was in better shape to capture the upside than Valero, the largest independent. It was a fitting climax to a remarkable 25-year run as CEO by William E. Greehey, who remains chairman. Greehey made his mark as a master consolidator. And he smartly invested billions to outfit his plants to refine heavy sour crude, which is cheaper than light sweet, giving Valero an enviable edge over refining rivals.

31

CONOCOPHILLIPS

» LIKE ITS RIVALS in the oil patch, ConocoPhillips is gushing with profits. But the nation's No. 3 oil major continues to separate itself from the pack with super-aggressive investments, such as the $36 billion acquisition of natural gas leader Burlington Resources Inc., due to be completed in March. By the end of 2006, CEO Mulva also plans to spend as much as $3 billion to raise Conoco's stake in Russia's OAO Lukoil to 20%. The company is also pushing ahead with major projects in politically risky places such as Venezuela and Libya, where it recently won approval to restart operations. Conoco is pouring big money into downstream operations as well. It has bought a refinery in Germany and announced a $5 billion, multiyear program to add capacity for processing heavy crude in the U.S. So far, Mulva's bets have paid big rewards for investors: Total returns have risen 41% annually since 2002, about double those generated by Exxon Mobil Corp. and Chevron Corp. As long as global energy demand keeps growing at its current torrid pace, Conoco's shareholders are likely to get many more happy returns.

INDUSTRY
Energy
SALES
$162.4 billion
NET INCOME
$13.6 billion

ARTHUR F. RYAN, 63
CEO since 1995

PRUDENTIAL FINANCIAL INC.

INDUSTRY
Insurance
SALES
$31.7 billion
NET INCOME
$3.6 billion

33

» INSURANCE companies aren't generally known for red-hot growth. But Newark (N.J.)-based Prudential Financial saw its profits rise 49% last year. Its stock, meanwhile, soared 33%, more than twice as much as its peers. Growth at the No. 3 U.S. provider of broker-sold variable annuities has been generated in part by a shopping spree. The latest deal, on Mar. 9, is Prudential's $560 million acquisition of Allstate Corp.'s variable annuity business. And CEO Ryan still has some $3 billion in capital with which he can buy back stock or make strategic acquisitions in an industry that is ripe for consolidation.

STEVEN A. BALLMER, 50
CEO since 2000

MICROSOFT CORP.

INDUSTRY
Software
SALES
$41.4 billion
NET INCOME
$13.1 billion

34

» IT'S EASY TO LOOK at Microsoft and see the warts. Annual sales growth has slowed to single digits, and upstarts are moving ahead in new, vibrant markets such as search. But give Microsoft its due: The company continues to crank out huge profits via its twin monopolies, the Windows operating system and the Office productivity suite. And long-running efforts, such as its server software business and Xbox game console, are contributing to financial results in meaningful ways. With its next version of Windows due out early next year, Microsoft seems poised for a new round of earnings growth. Wall Street is expecting 12% a year.

RICHARD C. ADKERSON, 59
CEO since 2003

FREEPORT-McMORAN COPPER & GOLD INC.

INDUSTRY
Metals & Mining
SALES
$4.2 billion
NET INCOME
$995 million

35

» FREEPORT'S profits more than quadrupled, and shares soared in 2005, on sky-high copper and gold prices and strong production at its unrivaled Grasberg mine in Indonesia. Except for Hurricane Katrina, which devastated Freeport's home city of New Orleans, it was "a year we'd like to live over again," CEO Adkerson said recently. But this year, ever-tense relations with locals have erupted in a new spate of protests at Grasberg. Four guards were killed in March, and operations were halted for four days. Still, Adkerson is upbeat: Copper demand remains strong, and Freeport has quieted discord in Indonesia before.

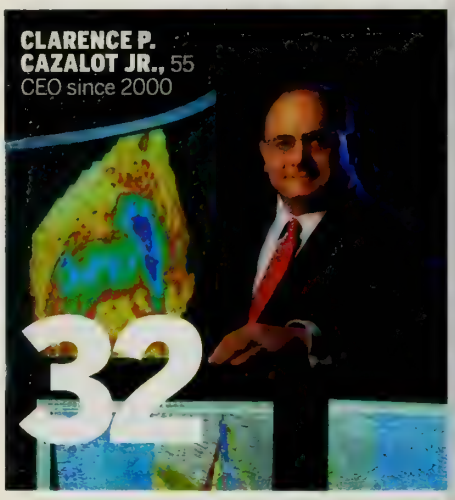
BERNARD J. DUROC-DAN
52, CEO since

WEATHER INTL. LTD.

INDUSTRY
Energy Equipn Services
SALES
$4.3 billion
NET INCOME
$466 million

36

» FOUNDED IN Weatherford h expanded rapi through acqui and now does business in 10 countries. Its r recent deal: th billion purchas year of Precisi Drilling Corp.'s services and c drilling operati a strategy that produced com annual stock r of 27% for nea years running. Houston comp now a leading of equipment tools that allov companies to collect data fr in remote part world. Last yea helped Chevrc set an industr by drilling the Mexico's deep boring down a 6½ miles.



CLARENCE P. CAZALOT JR., 55
CEO since 2000

32

MARATHON OIL CORP.

» ALTHOUGH IT ranks a distant No. 4 among U.S.-based oil majors, Marathon is winning respect in a global industry where size is supposed to matter. The onetime USX subsidiary had an impressive eight discoveries out of 11 wildcat wells last year. The Houston-based company also scored a big coup in 2005 when it was allowed back into Libya, one of the world's most prolific areas, after being shut out for 19 years. CEO Cazalot, a former Texaco executive, also has ramped up downstream investments. He spent about $4 billion to buy out joint venture partner Ashland Inc.'s share in a refining, marketing, and transportation operation. And after completing a big expansion of Marathon's Detroit refinery, he recently announced a $2.2 billion upgrade of a Louisiana facility. Downstream businesses kicked in more than half of Marathon's operating income last year. Refining margins have already softened from last year's hurricane-induced spikes but are expected to remain at historically high levels until major new U.S. capacity comes onstream in a few years.

INDUSTRY
Energy
SALES
$58.6 billion
NET INCOME
$3.1 billion

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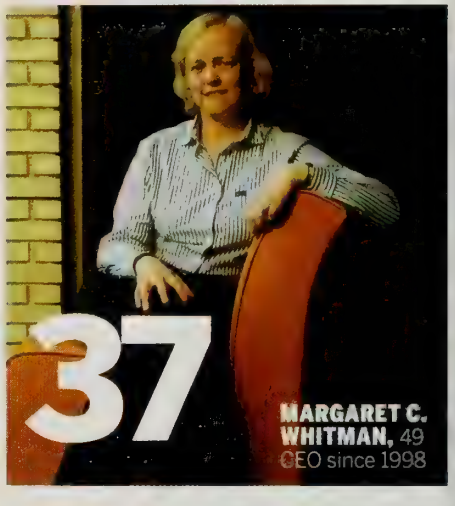
DALE B. WOLF, 50
CEO since 2005

THOMAS M. RYAN, 53
CEO since 1994

FREDERICK W. SMITH, 61
CEO since 1971

GREGORY E. JOHNSON, 4
CEO since 20



MARGARET C. WHITMAN, 49
CEO since 1998

37 EBAY INC.

INDUSTRY
Internet Services
SALES
$4.6 billion
NET INCOME
$1.1 billion

» DESPITE NEW COMPETITION from the likes of Google Inc. and its GoogleBase classified ad service, eBay is still humming. Sales last year jumped 39%, to $4.6 billion, thanks in part to the rapid expansion of online payment unit PayPal Inc., which eBay bought in 2002. The San Jose (Calif.) online marketplace is counting on more savvy acquisitions to make up for slow growth in its core U.S. auction market, spending $3.6 billion in a yearlong shopping spree. The biggest prize eBay won was $2.6 billion-plus Internet phone phenom Skype Technologies, which it hopes will grease communication between buyers and sellers. The challenge for Whitman & Co. this year will be to manage this batch of acquisitions. At the same time, eBay is unleashing a flurry of new initiatives aimed at drawing a wider variety of merchants and retailers to sell or advertise on eBay. EBay Express, for instance, will let merchants more easily sell new items at fixed prices. Doing all of that won't be easy. The resulting uncertainty may be why investors have knocked eBay's stock down 15% since the beginning of the year.

38 COVENTRY HEALTH CARE INC.

INDUSTRY
Managed Health Care
SALES
$6.6 billion
NET INCOME
$502 million

» MANAGED-CARE company Coventry is thriving in a business otherwise dominated by a handful of big players. An emphasis on cost control has yielded 12% operating margins, among the best in the industry. Last year, the Bethesda (Md.) insurer spent $1.8 billion to buy First Health Group Corp., giving it a national provider network of 4,500 hospitals and 450,000 doctors and clinics, as well as an entrée into managing workers' comp claims. Coventry has about 500,000 clients in Medicare drug plans, but it only dipped a toe into consumer-directed health care. "Everything in moderation," emphasizes Wolf.

39 CVS CORP.

INDUSTRY:
Drug Retail
SALES:
$37 Billion
NET INCOME:
$1.2 billion

» CVS, THE NATION'S largest retail pharmacist, has the wind at its back. Sales of prescription drugs account for 70% of its business, all growing thanks to an aging population of baby boomers and rising use of generics. Net income soared 33% in 2005, on a 21% increase in sales. The Woonsocket (R.I.) company also has been smart about driving sales in the front of the store. It has used its loyalty-card program, the country's biggest, to bolster sales of beauty aids and other products. CVS got a big boost with the purchase of some 1,100 stores from Eckerd Corp. in 2004. This summer, it expects to add 700 Albertson's outlets.

40 FEDEX CORP.

INDUSTRY
Air Freight & Logistics
SALES
$30.9 billion
NET INCOME
$1.6 billion

» THE RISE OF FAX and e-mail should have spelled doom for FedEx, which made its name in the '70s and '80s delivering critical documents for customers. It didn't. Realizing that the trend toward just-in-time manufacturing created new opportunities for carriers that could "absolutely, positively" guarantee delivery down to the hour, FedEx persuaded Corporate America to view its jets and trucks as mobile warehouses. The sales pitch worked, and now FedEx is thriving as never before. Sales have topped $30 billion, while profits increased 21% last year. Since 2004, shares have risen more than 50%.

4 FRANKLIN RESOURCE INC.

INDUSTRY
Diversified Fin
SALES
$4.5 billion
NET INCOME
$1.1 billion

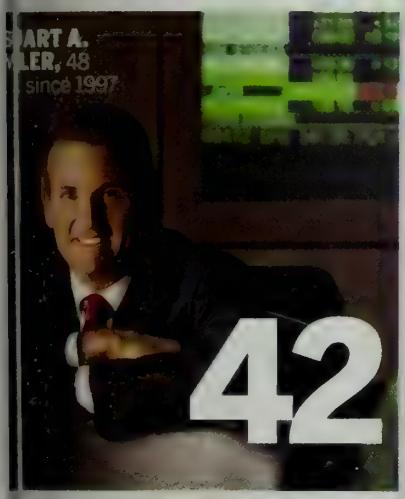
» FRANKLIN Resources, the largest of the p traded U.S. mu fund companie been on a tear stock is up an annualized 43 the past three and profits are The San Mate company's po Templeton international r funds have att increased inve interest as fore equities have outpaced dom issues. This ye management repatriate nea billion in foreig earnings. Fran won't say wha do with the wi but by law it c among other t move toward acquisitions o research and development.

LEW FRANKFORT, 60, CEO since 1995

RONALD L. SARGENT, 50 CEO since 2002

JEN-HSUN HUANG, 43 CEO since 1993

CHARLES W. MOORMAN, 54 CEO since 2005



ART A. LER, 48 since 1997

42 LENNAR CORP.

ROARING GROWTH in California and where homebuilder Lennar did nearly ts business last year, helped propel the company to five-year compound annual of 42% in profits and revenue. But now those er markets are softening, company plans to he hammer more slowly. ing for 13% growth in es this year. Analysts say can tolerate a weaker market better than some rivals because sciplined land-buying program, its ative 33% ratio of nonfinancial services capital, around $1 billion in cash, and an nistic culture. With LNR Property Corp., a rcial real estate developer it spun off in nnar builds communities that include , offices, and retail. It specializes in ing former military bases. Lennar might rket share in a housing downturn it snaps up land and smaller builders at ottoms. For now, it's trying to rev up suddenly cooling Palm Beach, Fla., after roker commissions to 2% in 2004, it set tice brokers by raising commissions last s high as 5% for multiple sales.

INDUSTRY Homebuilding
SALES $13.9 billion
NET INCOME $1.3 billion

43 COACH INC.

INDUSTRY Consumer Discretionary
SALES $1.9 billion
NET INCOME $455 million

BETWEEN THE cheap handbags and ones that cost as much as a car, there's Coach. The New York accessories maven has deftly cultivated the "accessible luxury" segment, selling fashionable, well-made items to consumers who want quality without a ridiculous price tag. Coach has avoided the bargain bin dilution that has plagued brands from Calvin Klein Inc. to Tommy Hilfiger Corp. It doesn't slash prices on the Web or at full-price stores. Coach's factory outlets are generally about an hour's drive from its retail stores. That keeps fashionistas apart from suburban moms who may not care if a cherry-red wristlet is so last year.

44 STAPLES INC.

INDUSTRY Specialty Retailing
SALES $16.1 billion
NET INCOME $834 million

SARGENT MANAGED to expand profits by 18% last year—not bad for a business that might seem mature. He also boosted margins by selling Staples' brand office supplies in his own outlets as well as in a growing number of grocery stores. In 2005, Sargent added close to 100 new stores to his network of 1,780 in North America and Europe. But for the Framingham (Mass.) company, the biggest sales growth these days comes from delivering office supplies to businesses, most of which order online. Sales through staples.com jumped 27%, to $3.8 billion, last year. That's quite a pile of pencils and paper clips.

45 NVIDIA CORP.

INDUSTRY Information Technology
SALES $2.4 billion
NET INCOME $303 million

FOR A TIME, NVIDIA could do no wrong. Its graphics chips were the preferred choice of PC gamers and hip companies like Apple Computer Inc. Investors have been fond of the company, too, thanks to a total return over three years of 273.5%. But while profits soared 202% on an 18% rise in sales last year, rivals have been muscling into the graphics chip market. So CEO Huang has moved to diversify, winning a potentially lucrative slot in Sony Corp.'s upcoming PlayStation 3, due in November, and branching out into high-end cellular phones and medical devices. The big challenge: making those low-margin businesses profitable.

46 NORFOLK SOUTHERN CORP.

INDUSTRY Railroads
SALES $8.5 billion
NET INCOME $1.3 billion

THIS IS ONE railroad company that's really chugging along. Powered by a global economy shipping goods to all corners of the country and zooming oil prices that made rail-shipped coal a hot commodity, the Norfolk (Va.) company turned in steaming financials in 2005. Profits shot up 39%, to $1.3 billion, on a 16% increase in sales of $8.5 billion. But the company, which runs 21,300 miles of track, mostly in the eastern U.S., isn't just riding high on a shipping boom. Best-of-breed technology keeps trains running on time, and helped Norfolk achieve an industry-leading profit margin of 15.1% last year.

THE WE'RE ALL ON
A DIFFERENT PAGE ERA IS OVER
Your potential. Our passion.™
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Microsoft® Office has evolved. Have you?
After all, the way we work has changed. These days, the bigger the team, the harder it is to work together. That's why the latest version of Microsoft Office allows easy access to Team Workspaces. Step up to a world where shared locations hold documents, schedules, tasks, and announcements. It's time to evolve the way you work. Discover how at microsoft.com/office/evolve
It's time to upgrade our Office 97.
Brilliant.
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Office

THE BUSINESSWEEK 50

JOHN H. HAMMERGREN, 46
CEO since 2001

RAMANI AYER, 58
CEO since 1997

ROBERT L. NARDELLI, 57
CEO since 200

JAMES W. OWENS, 60
CEO since 2004

47

CATERPILLAR INC.

INDUSTRY
Machinery
SALES
$36.3 billion
NET INCOME
$2.9 billion

» **THESE DAYS, MOST** old-line manufacturers are cutting American jobs as they struggle against low-cost foreign rivals. Not Caterpillar. The Peoria maker of heavy-duty machinery and engines, and the only capital-goods outfit on this year's BusinessWeek 50 list, boosted its headcount by 8,200 people, or 10.5%, in 2005, with the bulk of its new hires in the U.S. Cat needs the added help to keep up with demand fueled by the boom in construction, energy, and raw materials. Indeed, the waiting list for some of Cat's biggest equipment is years long. Little wonder, then, that its profits jumped 40% in 2005, or that its one-year total return to shareholders ranked No. 27 among all companies in the Standard & Poor's 500-stock index. Owens, a 34-year company vet, anticipates another strong year in 2006, with income rising at least 15% and sales increasing 10%, to $40 billion. Owens also has begun to gird Caterpillar against the next cyclical downturn in the industrial cycle with a big push into service businesses such as remanufacturing and logistics. Owens' ambitious goal is to make Cat a $50 billion company by decade's end. At the rate Caterpillar is growing, he may get there early.

(L TO R) PHOTOGRAPHS BY (OWENS) MICHAEL L. ABRAMSON; (NARDELLI) DANIEL ACKER/BLOOMBERG NEWS

48

McKESSON CORP.

INDUSTRY
Health-Care Distributors
SALES
$85.9 billion
NET INCOME
$776 million

» **McKESSON, THE** world's biggest drug distributor, came up with a cure for a splitting legal headache last year. A $960 million settlement ended a suit stemming from a massive 1999 earnings restatement that contributed to the San Francisco company's ending in the red in fiscal 2001. Now, McKesson's focus is squarely back on distributing medicines to pharmacies and hospitals. That's sweet relief, as growth in generic drug sales has bolstered margins in this notoriously low-margin business. Also helping get McKesson back in the black: sales of its new, higher-margin health-care management software.

49

HARTFORD FINANCIAL SERVICES GROUP INC.

INDUSTRY
Insurance
SALES
$27.1 billion
NET INCOME
$2.3 billion

» **TO DRIVE FRESH** growth, Ayer is pushing rapidly into wealth management and retirement planning. Sales of 401(k) plans, one of Hartford's fastest-growing products, jumped 31%, to a record $3.2 billion in 2005. Hartford is also making inroads internationally. One especially hot performer is its Japan annuity business, which last year saw assets surge 53% over the prior year. Continued growth in the Maryland-based firm's bread-and-butter life insurance and variable annuities sales, as well as a foray into new international markets, helped push assets under management up 11% last year, to $323 billion.

50

THE HOME DEPOT INC.

INDUSTRY
Specialty Retail
SALES
$81.5 billion
NET INCOME
$5.8 billion

» **THIS AIN'T Y** daddy's Home anymore. The boom along wi efficiency push 2,047 stores ha helped the Atla home improve giant turn in ste financial result Sales shot up f $46 billion in 2 $81.5 billion la and profits hav than doubled. Nardelli is look beyond the big store, to the $4 billion market t supply profess contractors. He spent billions, up more than companies, to out the Home Supply unit. Bu stock price, at $43, hasn't foll suit: It has bare budged since N took over in De ember, 2000.

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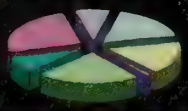
INDEPENDENT SOURCES

NEW



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Inside The Ranking

The S&P 500 represents a huge universe, accounting for some 74% of the market capitalization of all U.S. stocks. The numbers we used to rank them in our proprietary formula are shown in these tables, along with a wealth of additional financial information. For full rankings of the S&P 500 companies go to **www.BusinessWeek.com/BW50.**

GLOSSARY & FOOTNOTES

companies on this list are from the Standard & Poor's 500. Each company is ranked by ten criteria: one-year total return; three-year total return; one-year sales growth; three-year average annual sales growth; one-year profit growth; three-year average annual profit growth; net profit margins; and weighted long-term earnings growth, with additional weight given to a company's sales debt-to-capital ratio. A company's composite rank is calculated using the sum of its ranks.

MARKET VALUE
Stock price on Feb. 28, 2006, multiplied by the total available common shares outstanding.

TOTAL RETURN (1 YEAR)
Total dividend per share, reinvested, plus Feb. 28, 2006, share price, as a percent of Feb. 28, 2005, share price.

TOTAL RETURN (3 YEAR)
Total dividend per share, reinvested, plus Feb. 28, 2006, share price, as a percent of Feb. 28, 2003, share price.

SALES
Total available sales through the most recent 12 months ended Jan. 31, 2006. Includes all sales and other operating revenues. For banks, this includes revenues from banking operations.

SALES THREE-YEAR AVERAGE CHANGE
Calculated using the least-squares method. Data for 2005 and 2004 are as reported by company in 2005.

PROFITS
Latest available profits through the most recent 12 months ended Jan. 31, 2006. Net income from continuing operations before extraordinary items.

PROFITS THREE-YEAR AVERAGE CHANGE
Calculated using the least-squares method. Data for 2005 and 2004 are as reported by company in 2005. If results for one of the earliest three years are negative or not available, the average is for two years.

NET MARGINS
Net income from continuing operations before extraordinary items as a percent of sales.

RETURN ON INVESTED CAPITAL
Net income available for shareholders as a percent of debt and equity funds.

LONG-TERM EARNINGS GROWTH
The median estimate by analysts of the annual growth rate of earnings compiled by Thomson First Call. For most companies, this is for the next 3-5 years.

RECENT SHARE PRICE
Price for a single share of a company's most widely traded issue of common stock as of the close of trading Feb. 28, 2006.

HIGH/LOW PRICE
Trading range for the company's common stock, Feb. 27, 2005, to Feb. 28, 2006.

P-E RATIO
Price-earnings ratio based on latest 12 months' earnings and Feb. 28, 2006, stock price.

DIVIDEND YIELD
Annual dividend rate as a percent of the Feb. 28 stock price.

ESTIMATED EARNINGS PER SHARE
Diluted earnings per share, excluding extraordinary profit or loss, divided by number of common and common equivalent shares.

EARNINGS PER SHARE ESTIMATES
Analysts' consensus estimates for 2005 compiled as of Feb. 28, 2006, by Thomson First Call.
(a) Data as of September, 2005.
(b) Data as of October, 2005.
(c) Total return from Oct. 3, 2005.
(d) Total return from Jan. 3, 2006.
(e) Two-year growth rate.
(x) Sales include excise taxes.
(y) Sales include other income.
(z) Sales include excise taxes and other income.
NA=not available. NC=not calculable. NM=not meaningful. NR=not ranked. INC=incomplete.
† Because *BusinessWeek* is owned by The McGraw-Hill Companies, the S&P 500 Scoreboard does not include a forecast of the company's earnings.

Note: Compustat data provided by Standard & Poor's, from sources such as statistical services, registration statements, and company reports that S&P believes to be reliable but are not guaranteed by S&P or *BusinessWeek* as to correctness or completeness. This material is not an offer to buy or sell any security.

Additional data: Thomson First Call.

THE BUSINESSWEEK 50 THE TOP PERFORMERS OF THE S&P

RANK		COMPANY	MARKET VALUE			SALES			PROFITABILITY	
2006 RANK	2005 RANK		FEB. 28, 2006 $ MIL.	TOTAL RETURN (1 YEAR)	TOTAL RETURN (3 YEAR)	12-MONTH 2005 $ MIL.	CHANGE FROM 2004 %	3-YEAR AVERAGE CHANGE %	12-MONTH 2005 $ MIL.	CHANGE FROM 2004 %
1	14	**Apple Computer** AAPL	57916.3	52.7	812.6	16190.0	66	40.9	1605.0	216
2	35	**WellPoint** WLP	50714.0	25.8	157.6	45136.0	117	47.5	2463.8	157
3	22	**Caremark Rx** CMX	22117.9	30.0	184.9	32991.3	28	78.3	932.4	55
4	5	**UnitedHealth Group** UNH	79076.3	27.8	181.3	45365.0 y	22	22.6	3300.0	28
5	166	**Schlumberger** SLB	67712.2	53.9	186.4	14309.2	25	4.1	2199.0	117
6	6	**Occidental Petroleum** OXY	36809.9	32.4	227.6	15208.0	34	26.9	5272.0	102
7	129	**Halliburton** HAL	34884.0	56.5	252.6	20994.0 y	3	19.6	2357.0	512
8	13	**Qualcomm** QCOM	77814.0	32.0	179.1	6024.0	19	21.5	2250.0	23
9	106	**Amgen** AMGN	92387.5	22.5	38.1	12430.0	18	30.6	3674.0	55
10	63	**Aetna** AET	28891.5	39.8	385.0	22491.9 y	13	4.8	1634.5	35
11	64	**Lowe's** LOW	53453.1	16.4	75.0	43243.0	19	17.8	2771.0	27
12	200	**Burlington Northern Santa Fe** BNI	29220.3	58.5	230.3	12987.0	19	13.4	1531.0	94
13	143	**Motorola** MOT	53303.1	37.8	194.0	36843.0	18	11.0	4599.0	110
14	8	**Yahoo!** YHOO	45851.0	-0.7	207.5	5257.7	47	80.6	1896.2	126
15	116	**Goldman Sachs Group** GS	61767.9	31.0	109.3	43391.0	45	24.1	5626.0	24
16	151	**Lehman Brothers Holdings** LEH	39616.2	61.2	169.6	32420.0	53	24.4	3260.0	38
17	47	**Gilead Sciences** GILD	28627.1	80.2	266.3	2028.4	53	62.1	813.9	81
18	153	**Jabil Circuit** JBL	7759.3	47.2	127.9	8095.4	23	29.3	252.8	40
19	83	**Best Buy** BBY	26387.4	50.7	184.1	29382.0	10	12.3	1018.0	16
20	229	**EMC** EMC	33425.7	10.7	89.7	9664.0	17	22.2	1133.2	30
21	163	**Baker Hughes** BHI	23225.3	45.0	126.7	7185.5	18	13.8	874.4	66
22	139	**Texas Instruments** TXN	47658.2	13.2	80.3	13392.0	6	18.0	2324.0	25
23	46	**Cisco Systems** CSCO	124516.5	16.2	44.8	25946.0	10	11.4	5581.0	4
24	33	**Starbucks** SBUX	27861.3	40.2	209.8	6713.8	20	24.8	523.9	24
25	55	**Intel** INTC	121931.4	-12.9	22.5	38826.0	13	13.2	8664.0	15
26	—	**D. R. Horton** DHI	10649.8	5.0	284.1	14246.7	28	24.5	1539.6	49
27	—	**National Oilwell Varco** NOV	10615.2	34.3	170.6	4644.5	100	41.8	286.9	149
28	242	**JPMorgan Chase** JPM	143442.8	16.8	102.9	79902.0	40	23.1	8483.0	90
29	188	**Merrill Lynch** MER	70693.6	33.6	135.1	47783.0	46	19.1	5116.0	15
30	4	**Valero Energy** VLO	33211.1	51.7	463.8	81362.0	51	42.5	3590.0	99
31	2	**ConocoPhillips** COP	83993.7	12.3	158.5	162405.0	37	45.9	13640.0	68
32	54	**Marathon Oil** MRO	25873.4	52.3	231.8	58596.0	30	28.7	3051.0	143
33	117	**Prudential Financial** PRU	38481.0	36.5	165.8	31708.0 y	13	5.8	3602.0	49
34	42	**Microsoft** MSFT	279018.1	8.1	29.5	41359.0	7	10.5	13057.0	31
35	350	**Freeport-McMoRan Copper & Gold** FCX	9318.2	28.0	230.1	4179.1	76	27.4	995.1	392
36	—	**Weatherford International** WFT	14990.0	44.7	115.4	4333.2	38	22.9	466.2	38
37	19	**eBay** EBAY	56251.6	-6.5	104.3	4552.4	39	54.9	1082.0	39
38	—	**Coventry Health Care** CVH	9685.6	41.7	373.5	6611.2	24	22.2	501.6	49
39	74	**CVS** CVS	23069.3	14.3	132.1	37006.2	21	15.2	1224.7	33
40	39	**FedEx** FDX	32588.3	10.1	110.7	30851.0	13	13.4	1575.0	21
41	71	**Franklin Resources** BEN	26506.2	51.3	229.6	4505.5 y	25	22.0	1135.6	47
42	—	**Lennar** LEN	9431.5	-0.6	149.7	13867.0	32	23.6	1344.4	42
43	17	**Coach** COH	13668.7	28.7	299.9	1933.9	27	32.7	454.6	46
44	61	**Staples** SPLS	17925.0	17.7	116.0	16078.9	11	11.5	834.4	18
45	345	**NVIDIA** NVDA	8067.5	62.6	273.5	2375.7	18	8.5	302.6	202
46	107	**Norfolk Southern** NSC	20978.0	44.5	179.7	8472.0	16	10.8	1281.0	39
47	23	**Caterpillar** CAT	49027.0	56.5	230.0	36339.0	20	22.8	2854.0	40
48	237	**McKesson** MCK	16563.8	45.7	107.3	85876.8	10	16.0	776.0	NM
49	82	**Hartford Financial Services** HIG	24891.3	16.4	140.6	27083.0	19	18.5	2274.0	8
50	89	**Home Depot** HD	89526.6	6.4	84.7	81511.0	12	11.9	5838.0	17

NET MARGIN 2005	NET MARGIN 2004	RETURN ON INVESTED CAPITAL	INVESTMENT DATA RECENT SHARE PRICE $	12-MONTH HIGH/LOW $	P-E RATIO	DIVIDEND YIELD	EARNINGS PER SHARE 2004	ESTIMATED EARNINGS PER SHARE 2005	INDUSTRY GROUP
9.9	5.2	19.2	68	86/33	37	0.00	1.86	2.13	Technology Hardware & Equip.
5.5	4.6	7.9	77	80/58	19	0.00	3.94	4.57	Health-Care Equip. & Svcs.
2.8	2.3	10.9	50	54/37	24	0.00	2.05	2.30	Health-Care Equip. & Svcs.
7.3	7.0	15.3	58	65/44	23	0.05	2.48	2.90	Health-Care Equip. & Svcs.
15.4	8.8	18.8	115	132/65	32	0.87	3.62	4.95	Energy
34.7	22.9	28.9	92	98/64	7	1.57	12.89	10.69	Energy
11.2	1.9	25.3	68	82/40	15	0.88	4.54	3.99	Energy
37.4	36.1	18.8	47	49/32	36	0.76	1.32	1.49	Technology Hardware & Equip.
29.6	22.4	16.2	75	87/56	26	0.00	2.93	3.46	Pharmaceuticals & Biotech
7.3	6.1	14.5	51	52/34	19	0.04	2.70	2.75	Health-Care Equip. & Svcs.
6.4	6.0	15.5	68	70/51	20	0.35	3.46	4.02	Retailing
11.8	7.2	9.4	79	82/46	20	1.02	4.01	4.76	Transportation
12.5	7.0	22.5	21	25/14	12	0.75	1.82	1.30	Technology Hardware & Equip.
36.1	23.5	20.4	32	44/31	25	0.00	1.28	0.54	Software & Svcs.
13.0	15.3	4.3	141	146/95	13	0.99	11.21	11.86	Diversified Financials
10.1	11.1	4.0	146	150/86	13	0.66	10.87	11.35	Diversified Financials
40.1	33.9	24.8	62	64/34	36	0.00	1.72	2.07	Pharmaceuticals & Biotech
3.1	2.7	9.9	38	41/26	31	0.00	1.22	1.65	Technology Hardware & Equip.
3.5	3.3	18.8	54	56/32	27	0.59	2.02	2.64	Retailing
11.7	10.6	9.3	14	15/11	30	0.00	0.47	0.66	Technology Hardware & Equip.
12.2	8.6	15.1	68	78/42	27	0.77	2.56	3.57	Energy
17.4	14.8	18.9	30	35/23	21	0.40	1.39	1.47	Semiconductors
21.5	22.8	24.3	20	20/17	23	0.00	0.87	1.05	Technology Hardware & Equip.
7.8	7.6	23.4	36	37/22	55	0.00	0.65	0.70	Consumer Svcs.
2.3	22.0	22.6	21	29/20	15	1.94	1.40	1.23	Semiconductors
10.8	9.2	14.1	34	43/27	7	1.17	4.84	5.42	Consumer Durables & Apparel
6.2	5.0	5.7	61	78/39	34	0.00	1.81	3.04	Energy
0.6	7.8	3.7	41	42/33	17	3.31	2.38	3.37	Diversified Financials
10.7	13.6	3.4	77	78/52	15	1.30	5.16	5.99	Diversified Financials
4.4	3.4	17.7	54	64/29	9	0.45	6.10	7.54	Energy
8.4	6.8	21.1	61	71/48	6	2.36	9.63	9.75	Energy
5.2	2.8	20.6	71	78/43	8	1.87	8.49	9.69	Energy
1.4	8.6	11.6	77	79/55	12	1.01	6.46	5.63	Insurance
31.6	26.0	29.5	27	28/24	22	1.34	1.20	1.32	Software & Svcs.
3.8	8.5	30.5	51	65/32	11	2.47	4.67	3.39	Materials
0.8	10.8	7.7	43	46/24	29	0.00	1.47	2.26	Energy
3.8	23.8	10.8	40	48/31	51	0.00	0.78	1.02	Software & Svcs.
7.6	6.3	15.1	60	62/41	19	0.00	3.10	3.47	Health-Care Equip. & Svcs.
3.3	3.0	12.2	28	32/24	20	0.55	1.45	1.57	Food & Staples Retailing
5.1	4.8	12.5	107	109/77	21	0.30	5.12	6.52	Transportation
5.2	21.4	15.6	103	104/64	24	0.47	4.35	4.85	Diversified Financials
9.7	9.0	17.0	60	69/50	7	1.07	8.17	9.35	Consumer Durables & Apparel
3.5	20.4	33.4	36	37/25	30	0.00	1.18	1.24	Consumer Durables & Apparel
5.2	4.9	16.8	25	25/19	22	0.90	1.12	1.25	Retailing
2.7	5.0	20.8	47	51/21	29	0.00	1.65	2.36	Semiconductors
5.1	12.6	8.1	51	51/30	16	1.25	3.11	3.29	Transportation
7.9	6.7	11.8	73	74/41	18	1.37	4.04	4.95	Capital Goods
0.9	-0.3	11.3	54	55/35	22	0.44	2.50	2.62	Health-Care Equip. & Svcs.
.4	9.3	11.3	82	89/65	11	1.94	7.44	8.50	Insurance
7.2	6.8	19.7	42	44/35	15	1.42	2.72	3.07	Retailing

Adidas' World Cup Shutout

U.S. fans of soccer's big event will see only Adidas ads on television. Nike's response: A MySpace-style site for soccer nu

BY STANLEY HOLMES

IN NEW ADIDAS TV ADS, U.S. SOCcer star Pablo Mastroeni and Mexican soccer standout Jaime Lozano have three hours to recruit amateur players from the streets and beaches of Los Angeles. Their goal is to form one team of U.S. players and one team of Mexican-born players to square off in a sandlot soccer game. The ad, one in a series, is meant to capture the high-octane international rivalries that will erupt starting on June 9, the kick-off of FIFA World Cup Soccer. But all that competitive tension is nothing compared with how the company behind the ads, Adidas Group, feels about soccer when it comes to its nemesis, Nike Inc.

In the latest escalation of this decades-old rivalry, Adidas is pumping big bucks into soccer, the only category in which it leads Nike, to try to close the overall gap between the two companies. Over the next few months, Adidas is spending about $200 million to market all things soccer. Shoes, boots, national team jerseys, soccer balls, and more are featured in the ad campaign, dubbed "+10," which revolves around the idea that one player plus 10 others equals a team.

The World Cup's global TV and Web audience is bigger than the Olympics' or the Super Bowl's—28 billion in-home viewers worldwide. Adidas is an official sponsor and paid for the rights to shut Nike out of TV advertising in the U.S. for all 64 games. It's vital for Adidas "to dominate the World Cup," says CEO Herbert Hainer.

LEADING IN JAPAN

HAINER HAS SOME momentum, but he's under pressure to deliver more. After spending $3.8 billion to buy Reebok International last fall to boost Adidas' women's business, Hainer must prove the deal was more than a market share grab and integrate the companies smoothly. Meanwhile, Adidas, based in Herzogenaurach, Germany, has made gains in baseball and basketball in the U.S. and abroad. Its soccer business is growing in Europe at Nike's expense, and overall sales in Asia are rising faster than those of the U.S. sneaker giant. Adidas' global share of the branded footwear market is 34%, vs. Nike's 38%, according to NPD Group. But Adidas has surpassed Nike ove Japan. Even its once-prosaic adve which paled in comparison with iconic spots, has given way to cine edgy ads such as the World Cup can and spots featuring superstar Davic ham created by TBWA\Chiat\Da same agency that handles Apple Co er Inc.'s ads. Although it trails Nike U.S. by 14 share points, Adidas overall share outside the U.S. of 28 far from Nike's 31% (table).

Nike isn't about to concede any s Adidas. The Beaverton (Ore.) sho is beefing up its lead in basketb running, and since soccer is such portant gateway to brand loyalt children worldwide, it's also p back on the soccer field. "Our goal the No. 1 [soccer] brand in the says Nike President Charlie Denso

Locked out of ad placements in t during the World Cup games, Nik ing guerrilla to get exposure. Whi das blows its dollars on traditional ads, including locking up most of the outdoor signs in Germany, where the

ILLUSTRATION BY STEPHEN WEBSTER

es are being played, s taking the viral and route. The company d with Google Inc. to the world's first social rk for soccer fans, om. The site, which ed on Mar. 15, will roll 140 countries in 14 lan- s. Hoping to make Adi- onder why it spent all money on mere ads, s making the site a of top social network Space.com for soccer- ns to commune with her over their favorite players and download videos, create discussion , and the like. Nike expects millions le to register. "It's this enormous n everything [soccer] that exists e else that could make Joga.com so ays Stefan Olander, Nike's global director.

New **Attack**

Adidas aims to cut Nike's overall lead by investing in soccer, the only sport in which Adidas has the edge.

	ADIDAS	NIKE
Share of total U.S. market	21%	36%
Market share outside the U.S.	28%	31%
Share of European soccer market	36%	32%
Share of U.S. soccer market	48%	32%

Data: NPD Group, *Sporting Goods Intelligence*

-SHIFTING SHOES

AMPAIGN AND Web site are after the Brazilian phrase "*joga* or "play beautifully." Fans who a.com or visit Nike's site can sift layers of video clips, messages, involving Nike's star players as watch videos about the magic of -called *ginga* by Brazilians—in t nations. Fans can then down- clips to their iPods, computers, phones, or portable PlaySta- ays Trevor Edwards, Nike's vice- dent for global brand manage- ment: "Kids are talking online, connecting online, it's just a part of their world.... Gone are the days of one big ad, one big shoe."

If Nike has achieved maximum brand cachet through associations with top athletes such as Michael Jordan and Tiger Woods, Adidas is betting on buzz-generating designs and sponsorships of its own to win back share. Last year the company introduced a $250 computerized running shoe, Adidas 1, with a microchip that senses fit and performance and helps change the shoe's shape during a run. And it's looking to its World Cup ad blitz to position the recently launched +F50 Tunit soccer boots as the must-have footwear for soccer players, especially against Nike's Mercurial Vapor III boot, which has gained popularity as the lightest soccer shoe on the market. The Tunit allows wearers to customize the fit, including choosing among different weights for shoe chassis and cleats to match weather conditions and even the wearer's style of play.

Addressing local design trends is paying off, too. Adidas took the lead from Nike in Japan after sponsoring the Japan national team in the 2002 World Cup and by coming up with the adiZero, a lightweight, thin-soled sneaker that hit the spot with Asian consumers. Adidas was early to see the trend in Japan "to more lifestyle footwear and away from the technical, performance brands," says John Shanley, who follows Adidas for Susquehanna Financial Group.

Adidas is growing faster than Nike in other Asian markets, too, notably in China. It spent $80 million to be the exclusive sneaker sponsor of the 2008 Beijing Summer Olympics. "Nike could be rocked back on their heels...this all sets the stage for [expansion in] China," says Jeffrey Bliss, president of Javelin Group, an Alexandria (Va.) sports marketing firm. In fact, Adidas' gains in Asia pushed Nike to spend $44 million to sponsor the India national cricket team. That price tag may sound daft, but cricket is as much a gateway sport in India as soccer is in China.

All these frenzied moves and countermoves mean Adidas can't take its lead in soccer for granted. "I would never underestimate Nike's marketing muscle," says Sal Galatioto, president of Galatioto Sports Partners, a New York investment firm specializing in sports. "They always seem to have their finger on the pulse of what people want." Add to that pressure questions about whether Adidas can make the Reebok deal pay off, and the challenges of supplanting Nike in other markets remain huge. That's all the more reason Adidas needs its World Cup play to score early and often with fans. ■

DENIS DOYLE/GETTY IMAGES

A Turnaround Ace For New Orleans

Its schools were a mess before Katrina. Now they may be Bill Roberti's toughest job yet

CREEPING ROT At Hardin Elementary, peeling desks, mud, and the stench of mold

BY COLEMAN COWAN

JUST ONE LOOK A' Roberti's mug tells you need to know. V comes to busines brusque and focus much for small talk o Even as he folds h trunk of a body into the elementary desk that has become his makeshi space, he oozes steely resolve, through a dual career as a U.S. Ar serve colonel and corporate turn artist. He doesn't waste words, an he does speak, he booms. If th manding 59-year-old is more in than ever these days, it's becau knee-deep in the most daunting ch of his professional life: reconstitu entire New Orleans public school

Roberti is a managing dire Alvarez & Marsal LLC, the New Yo around consultant renowned for w Timex, Interstate Bakeries, and th Richard Scrushy HealthSouth into In June, 2005, the firm was aw modest contract to help straighten crooked finances of the New Orle tem's 117 schools and its adminis After Hurricane Katrina the job l looned into something unimaginab important. Even before Katrina 80% of the city and emptied it of al of its residents, the New Orleans school system was the worst of al U.S. cities and faced intractable con infighting, and racial tension. I knows the odds against the school than Roberti, who did similar f work at A&M for the St. Louis sch tem. Largely because of him and h 10,165 students are back in the 2 schools that are up and running.

The school board had faced a di to-day cash crunch early this year the city slowly repopulates, increas tax revenues and federal funds hav this year's budget off life support. T also helped by deferring $68 mi unemployment insurance paymen January, 2007. For the first time si rina, Roberti was able to propos anced budget to the school boar Mar. 21 meeting. But he is quick out that finances remain precariou hiccup could still send us into a tai

The original $16.7 million A&M got fror Superintenden ucation Cecil J has expanded t million, encom physical rebuil well as the initi

rk. Now the firm is reconstructing ncial and physical infrastructure of re 117-school system as well as sift- ough the real estate and insurance eated by the storm. Picard says the for the contract comes out of the Parish School Board budget, deficit had gaped to $112 million his year. So far, A&M has recovered nillion from private insurers and d a $30 million community disas- from the federal government.

1 the work began last summer, found a school system that was tional in a daunting number of was $450 million in debt, and lits in 2004 and 2005 showed em- were siphoning millions in unau- paychecks. Phantom workers got hecks for years after they retired terminated. The accounting de- t employed no accountants. spect of the system was not work- s Roberti, a divorced father of two laughters. He's now living in a ouse with other A&M workers in Algiers section.

makes the job harder is the city's devastation. It's been almost sev- hs since Katrina struck, yet condi- nain so putrid in some sections berti and 35 A&M colleagues in eans have each received eight vac- s for diseases such as typhoid htheria, and hepatitis. Some de- a hacking wheeze known locally na cough," caused by airborne ir- maining after the flood. At many ols it's like Katrina happened yes- t Joseph Hardin Elementary in r Ninth Ward, for example, over- rniture, collapsed ceilings, and h of mold make it hard to venture n a few feet into classrooms.

RCRUITS

RSTONE OF Roberti's rebuilding been the opening of charter Of the 20 public schools open in eans, 16 are charter schools; the r are run directly by the New Or- ol board. After Katrina, A&M di- cruiting of the principals and -many of whom had prior teach- ience, but none of whom, in the hools, were bound to the teach- contract. Some locals complain rti is "selling off the school sys- ch opposition isn't surprising; hools generate strong emotions wherever they're launched. But t D. Eisenhower Elementary Algiers, one of the new charter New Orleans, principal Cynthia

A&M'S ROBERTI Largely because of him and his staff, 10,165 students are back in class

Daunting Fix

» Alvarez & Marsal was hired to straighten out the New Orleans school system's finances. Now it's directing the rebuilding effort, too.

	PRE-KATRINA		POST-KATRINA*
SCHOOLS OPEN	117		20
STUDENTS	63	THOUSANDS	10
BUDGET	$430	MILLIONS	$235

*As of Mar. 20, 2006

Data: *BusinessWeek*, A&M Orleans Parish School Board Financial Report, State Superintendent of Education

Bernard is amazed at the streamlined chain of command A&M put in place: "Without the bureaucracy, things get done quickly and easily now."

Not everyone was eager to hand financial control to outsiders. Former school board President Torin Sanders refused to sign A&M's $16.7 million contract after the board voted to approve it last June. A proposal to install Roberti as interim superintendent met with cries of racism; the school superintendent is African American, and the board vote went along racial lines. Local attorney Willie Zanders obtained a court order temporarily blocking passage of this year's $430 million school budget because it didn't include $160,000 in salary for his client —an ex-operations chief suspended in a dispute with the previous school superintendent. "That's the kind of nonsense that goes on," says Roberti.

The political back-and-forth is a reality in the fractured city, but Roberti and his team have managed to earn the respect of many locals through an undeniable drive to get the job done. A mere two days after the storm, with schools empty and the city still lawless, Roberti and two colleagues, Sajan P. George and Rajeev Jain, used Roberti's military ID to negotiate National Guard checkpoints to reenter the city. Their goal: retrieve payroll records on computer data tapes from a school administration building in Algiers. Arriving just before nightfall, they sought protection from a New Orleans Police Dept. tactical unit set up at a nearby elementary school "so they would know what we were doing and we wouldn't be shot at," Roberti explains. They slogged through foul water and retrieved the tapes, allowing them to dole out paychecks to workers scattered across the nation within two weeks of the storm. "It was important to give employees the money they were owed as soon as possible—they had no homes and needed all the help they could get," says Roberti.

Making nice with community groups isn't a task that normally falls to corporate consultants, but Roberti has no choice. At a Jan. 5 school board planning meeting, he laid out the system's dire financial straits. With detailed spreadsheets of cash flow and budget amendments, he showed that at that point revenues for the 2005-06 school year were down $271 million from pre-storm forecasts and that the schools would be facing a $65 million yearend deficit in June.

The board members, a mix of educators and concerned parents with little experience managing multimillion-dollar operations, had trouble keeping up. They interrupted him. Some found it hard to read a balance sheet. "We'll get to that in a minute, if you'll let me finish," Roberti told more than one board member.

As he tried to wrap up, a chaotic discussion about possible insolvency erupted. Brief grimaces betrayed moments of frustration, yet Roberti kept his cool, answering each question in clipped rebuttals. Eventually, his no-nonsense style sparked grudging admiration: "Your straightforward manner is refreshing, Bill," said board member Una Anderson. "Like a punch in the face, but refreshing."

Seagate's Morale-athon

Inside the tech giant's $9,000-a-head team-building blowout in New Zealand

BY SARAH MAX

PLENTY OF COMPANIES try to motivate the troops, but few go as far as Seagate Technology. In February the $9.8 billion maker of computer storage hardware flew 200 staffers to New Zealand for its sixth annual Eco Seagate—an intense week of team-building topped off by an all-day race in which Seagaters had to kayak, hike, bike, swim, and rappel down a cliff. The tab? $9,000 per person. Correspondent Sarah Max went along for the bonding.

CEO WATKINS aims to break down barriers

NATIVE DANCING War paint, skirts, and a Maori chant for "Seagate is powerful"

SUNDAY "DON'T BE TOO COOL TO PARTICIPATE." It's cocktail hour, and nervous getting-to-know-you chatter floats around the Queenstown chalet, where we've arrived by gondola. Staffers from a dozen countries are talking and gazing out at a stupendous mountain view of The Remarkables. The employees been chosen from 1,200 who tried to get into Eco Seagate. (The company employs a total of 45,000.) There are no age limits: The oldest racer this year is 62.

In the first of many embarrassing exercises, four "tribes," each made up of 10 athletically, regionally, and operationally diverse teams, are asked to imitate the sound of the New Zealand birds for which their group has been named: Ruru, Kia, Tui, or Weka. "You're going to think some of this is pretty dumb," CEO Bill Watkins tells the crowd. "Just get involved. Don't be too cool to participate."

This event, or social experiment, is Watkins' pet project. He dreamed up Eco Seagate as a way to break down barriers, boost confidence, and, yes, make staffers better team players. "Some of you will learn about teamwork because you have a great team," he says. "Some of you will learn because your team is a disaster."

Watkins, whose company is the world's biggest maker of hard drives, knows about disastrous teams. When Seagate acquired his employer, Conner Peripherals, in 1996, hostility reigned as staffers jockeyed to guard their turf. "Corporate culture is the story of the company," says Watkins. "Back then, Seagate had lots of great stories—about people getting fired. We needed to create a different culture—one that was open, honest, and encouraged people to work together."

So how do you reprogram employees? You ask them to do something they've never done before, says Watkins, who took up adventure racing in the late 1990s and saw it as the perfect way to teach team-building. "You put them in an environment where they have to ask for help."

KAYAKING was part of an all-day race for the fou

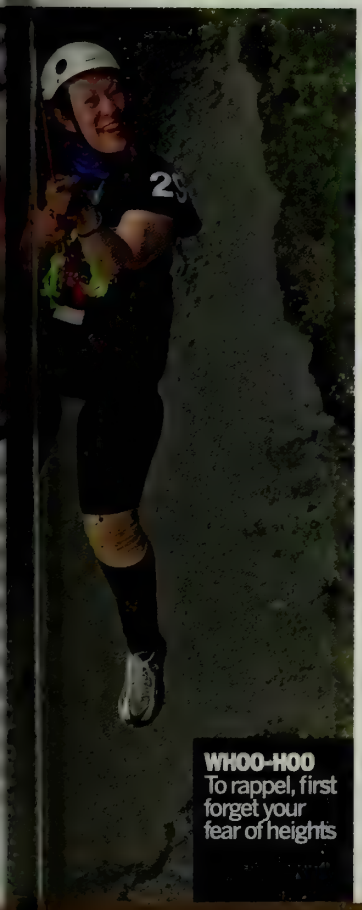
MONDAY BOOT CAMP IT AIN'T. "Oh, what a beautiful morning. Oh, what a beautiful day," croons Malcolm McLeod tralia's Motivation Worldwide. " out there and stretch." Dressed i garb, Malcolm and his gang of " have helped Eco Seagate run s since the first one in 2000. Over t the outing has evolved from just a tightly organized event with a lined message. Each morning, W one of his top executives gives a tation on a key attribute of a stro such as trust, healthy conflict, ment, accountability. That lesso

MAKINGMOVIES (4); (BOTTOM RIGHT) ROSS LAND/GETTY IMAGES

bending and groaning in the dark. "I don't like to schmooze for the sake of schmoozing," says Pope, who was initially opposed to the event because, for one thing, it costs a lot of money—about $1.8 million this year. That's a lot of hard drives. But it represents a fraction of the company's $40 million training-and-development budget.

In 2002, Pope caved in to Watkins' pleas to participate and came home a believer. Now, he says, Eco Seagate is one of the last things he'd cut from the budget. A lot of other companies might agree. While it's tough to find numbers for team-building events, partly because they're hard to define (a treasure hunt at a museum? a day at Disney World?), the business is growing fast, says Peter Grazier of TeamBuilding Inc. in Chadds Ford, Pa.

In the afternoon, the tribes head out for physical training. I'm "embedded" with the Rurus, who today will learn the most essential but least exciting skill of adventure racing—navigation—in the rolling hills overlooking Lake Wakatipu. The Five Elements team has done some team-building already: "We've been e-mailing almost every day since we got matched up," says Karri Barry, 37, a cash manager in Scotts Valley, Calif., where Seagate is headquartered. When the team gets maps and compasses today, they know that Choon Keong "C.K." Neo, 33, a quality manager in Singapore, will be the navigator, thanks to a stretch in his nation's military.



WHOO-HOO To rappel, first forget your fear of heights

CYCLING beside the South Island's Lake Wakatipu

over to the afternoon, when tribes go off to learn orienteering, rappelling, mountain biking, or kayaking.

Today we're up at 5:45 for the "optional" pre-dawn stretch. But this isn't exactly boot camp. For Eco Seagate the company has taken over Rydges Lakeland Resort in Queenstown, a mountain village on the South Island. All participants have their own comfy rooms. The stretch takes place in a park across the street. Seagate CFO Charles Pope, 50, and his Shark Attack team are among the throng

TUESDAY TESTING THE LIMITS. Watkins is pacing the stage of the hotel conference room, giving his morning pep talk. The speech: unscripted and emotional. The look: shaggy hair, cargo shorts, and trail-running shoes. Today he's wearing a backpack with the head of a large toy kiwi bird sticking out the top.

Yesterday each team was given one of these stuffed animals, its "sixth team member," and warned that one person must be in physical contact with it at all times. Many teams have strapped on the birds, dressed them, and even named them. Anyone caught without a bird will lose 15 green Eco tokens, which teams earn throughout the week and will use on race day to buy better maps, skip a checkpoint, or take a bridge over a frigid, fast-moving river.

At the rappel site, Pope's teammate

Tish Sanchez earns an extra token for volunteering to rappel off a bridge, her fear of heights be damned. The climbing instructors stay close. Still, Sanchez has to step out over the ledge and hang her life on a harness. "You can do it, Tish," says Pope encouragingly, standing on the bridge and looking down at his white-faced teammate. It's slow going at first, but halfway down, the usually reserved info tech manager starts yelling out: "Whoo-hoo!"

WEDNESDAY "SEAGATE IS POWERFUL. SEAGATE IS POWERFUL." Wearing war paint, headbands, and makeshift grass skirts, each tribe is performing its own uniquely choreographed *haka*—a Maori chant typically performed by native New Zealanders—in a competition worth 50 tokens to the winning tribe, as judged by a panel of Maoris. The chant—"*Moanaketi roopu kaha. Moanaketi roopu kaha*"—is said to mean: "Seagate is powerful. Seagate is powerful." But it could just convey: "What a bunch of nutcases."

"For me the race is anticlimactic," says COO David Wickersham, 49. "You learn so much about yourself in the first four days and, personally, I'm surprised by how people let their guard down." Tonight there's no question that people have shed their inhibitions. They've also shed some of their clothing: The men are shirtless, the women sport bathing suits and tank tops with skirts improvised from fabric of their team's color. There's a lot of chummy touching, though no canoodling that I can see.

But does all this expensive inhibition-ditching do anything for shareholders? Jeffrey Pfeffer, professor of organizational behavior at Stanford University's Graduate School of Business, says that while you can't measure the effect, companies with a "positive culture" probably outperform their peers. Of course, he adds, the underlying ethic has to live on after something like Eco Seagate. "If I send you off to an event and you go home and are treated like dog doo, it doesn't work."

THURSDAY "THE HARDEST YET" "How much water will there be on the course?"

"Will we have wet suits?"

"Did you say this could take us 10 hours?"

The night before the big test, Nathan Faavae, an adventure-racing superstar, is being bombarded with questions. He spent months studying maps and bushwhacking around Queenstown to design the course. "This will be the hardest Eco Seagate yet," says Faavae, who's a first-timer but tested the course with several veterans. He hands out bags filled with a map, jerseys, life jackets, and a radio.

FRIDAY TIME TO WALK THE WALK—AND SWIM THE SWIM. Here's the plan: The 40 teams are dropped on an island in the middle of Lake Wakatipu between 6 and 7 a.m. A conch sounds, and the teams race to their kayaks and paddle 1.5 miles to shore. Then, n with a compass, over 4.3 miles o rain, mountain- miles of rocks then rappel 160 canyon for a hy swim and hike.

Here's the ragged day of suffering. After start on the kaya ements runs teams on the hi on bikes, and p mad to secon "This pace is fee tle leisurely," jol Brown, 44, a manager from Minn. Everyon and speeds up hour later they climb the big hil

"Help me!" Kebiao Yuan, 41 dling his bike, sc he can't move. mates lift his le bike, rub his kno cles, and squeeze sickeningly swe gel into his mo he's back on his and Five Eleme the final stret bike leg. At the sition point they bikes, run to th canyon, and rap Then it's a 1.6-mile trek out, p ing, partly swimming in 50F cold to feel anything at all, Five crosses the finish line 5 hou minutes after the start—27 min the first-place team, Fuel, and f before the stragglers.

At the finish line they find showers, dry clothes, and tab with grilled meats and salads lously, all 40 teams make it, car silly kiwi birds.

I hang out near the beer, ce exhausted Seagaters will have s cal things to say about Watki mamie event. Instead they g how they loved it. Then I Pope's note of hard-headed consider this an investment," before the race, remarking that e-mail all staffers in his organiz ask what they'd do differently of Eco Seagate. "After all," he isn't a vacation." ■

PLAYBOOK: BEST-PRACTICE IDEAS

Team-Building
What Works, What Doesn't

DO MAKE PHYSICAL ACTIVITIES OPTIONAL
"Employees should be allowed to opt out if something doesn't work for them," says Peter Grazier of TeamBuilding Inc. Find another way for these staffers to join in, and make safety a priority.

CHECK YOUR BLACKBERRY AT THE DOOR If people are peeling off to catch up with their e-mail, it's not effective, says Lynda Ford of consultancy Ford Group: "You can't send people away from the office and expect there to be no blips in productivity."

THINK ABOUT TIMING If you're announcing layoffs, slashing benefits, or cutting out the annual holiday party, an elaborate training event might hurt morale more than it helps, says Ford.

INCLUDE STAFFERS FROM ALL LEVELS AND DIVISIONS
A company in crisis might want an event just for top dogs. If the goal is to strengthen the whole company, it's better to mix it up.

DON'T LOSE SIGHT OF THE GOAL
"Activities should be enjoyable but should all be aimed in one direction," says Foster Mobley of Foster Mobley Group, which has put on events for Deloitte, Citigroup, and Nokia.

LET THE BOSS RUN THE SHOW
Leaders should not be the primary facilitators of training events, says Mobley, because they may be part of the company's problems. The executives "need to be in the event and playing alongside everyone else."

FORGET TO FOLLOW UP
Ask employees what they got out of the event and what they're doing differently because of it, says Ford: "Don't view this as a one-time event but as part of a process."

BE A HYPOCRITE That is, stand up and talk to the group about what it means to be an effective team player, then go back to the office and act like a jerk.

ED BY
IERINE ARNST

JOVATIONS

nethane and ga-tsunamis

arbon dioxide from ies, cars, and other ines tends to grab all adlines. Yet the earth's missions of methane, a potent greenhouse gas CO_2, may play a bigger global warming than hought. Scientists at Wegener Institute for & Marine Research in ny have discovered sea mud volcanoes that lumes of the gas, which e up all the way to the s surface. Several nd such volcanoes imated to exist hout the world. ditional regions of the may be capable of ting a mega-tsunami sort that killed more 00,000 Asians at the 2004. Scientists at nia Institute of logy compared GPS nates, satellite images, ter-level indicators on eefs before and after at tsunami-causing Publishing in *Nature*, und that it was caused 00-mile rupture n tectonic plates, larger than computer had described. The hers now think cally similar areas— the Caribbean and between Taiwan and -face a higher tsunami n previously thought.

–*Adam Aston*

RESEARCH

AN AIR FORCE TROVE OF MEDICAL INFO MAY BE LOST

FOR 24 YEARS the Air Force has been collecting a huge trove of data on Vietnam veterans in an effort to determine the long-term effects of Agent Orange, a toxic defoliant sprayed on Vietnamese forests by the U.S. during the war. The Air Force Health Study now has some 87,000 biological specimens and volumes of long-term data on more than 2,200 soldiers, half of whom flew defoliant-spraying planes. But the study is set to end in September, and scientists are worried that its wealth of research will disappear if Congress doesn't appropriate funds to maintain it. In February, the Institute of Medicine issued a report recommending that the Air Force data be transferred to a new custodial organization so that scientists can continue to use it for medical research extending far beyond Agent Orange exposure. The cost, however, could run up to $500,000 a year.

SUPERBUGS

THE MIGHTY MORPHING MICROBES

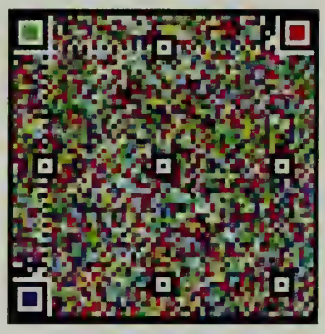
DRUG-RESISTANT staph infections have skyrocketed in hospitals, where they can turn a routine procedure into a weeklong confinement. Now the microbes are expanding their sphere of influence. A recent study in the *Annals of Internal Medicine* found that treatment-resistant staph may be the primary cause of skin infections outside the hospital.

Researchers at Emory University found that 72% of the community-acquired skin infections tracked in Atlanta were due to methicillin-resistant *Staphylococcus aureus* (MRSA) bacteria. Consequently, the authors recommended a powerful antibiotic, vancomycin, be used for treatment rather than the standard penicillin-like antibiotics given for community-based staph infections. That's a major prescribing change, and it may not work for long. MRSA is usually treated effectively with vancomycin in hospitals, but resistant strains of staph have already emerged.

DATA STORAGE

THE BAR CODE LEARNS SOME SNAZZY NEW TRICKS

THE BAR CODE ISN'T just a useful tool for retailers and overnight shippers. It can also be a powerful medium for advertisers. Japanese startup Content Idea of Asia (CIA) says it has invented a printable bar code that stores bulky data files such as video clips in a space just the size of a postage stamp. These can be swiped with a cell phone and the contents then viewed on the phone's small screen. The code, dubbed paper memory, could add a high-tech gloss



to conventional print ads.

Traditional zebra-stripe bar codes can't store much data. There are square bar codes that hold far more, in a two-dimensional matrix that's read up and down and side to side. CIA's PM Code adds color. In tests, the company's research chief, Kazuhiro Miwa, has shown that a paper memory code with eight color layers can store 600 kilobytes —enough for 20 seconds of low-resolution video. Snap a picture with the cell phone's camera, and the codes can activate the handset's Internet service to pull up an advertiser's home page, or view the embedded images. CIA hopes to sell its code in Japan later this year.

–*Kenji Hall*

Cooking Up A Vacation

Foodie travelers are causing a boom in hands-on culinary programs. **BY AMY CORTESE**

FISH DISH AT L'OASIS

CHRISTY CLARK FINISHED her four-hour shift in the kitchen of Kuleto's Italian Restaurant in downtown San Francisco, where she prepped a salad of blood oranges, blue cheese, and beets and rolled out freshly made pasta that would feed some 600 diners. Exhausted but exhilarated, she shed her toque at 6 p.m. and sat down to a meal in the dining room. Clark is no chef. She's a mother of two from Sacramento who, in late January, drove two hours with her husband and kids and paid $150 to toil in Kuleto's kitchen, staying in the adjacent Villa Florence Hotel. Clark was participating in the Chef for a Day program, which lets amateur cooks work in the restaurant's kitchen to raise money for the San Francisco Food Bank (sffoodbank.org/pdfs/chef4aday.pdf). "I'm not crazy enough to be a chef," says Clark, a former food photographer who loves to cook. "But I'm so interested in how it all works."

That enthusiasm is shared by a growing number of Americans who enjoy a steady diet of TV cooking shows and celebrity chefs. Like Clark, who combined her Chef for a Day stint with a visit to in-laws, they are fueling a boom in culinary travel.

Fine dining has long been a critical aspect of travel, as anyone who has ever planned a trip around a hard-to-get restaurant reservation can attest. Americans spent $131 billion on food while traveling domestically in 2004, more than they did on lodging, according to the Travel Industry Association of America. But these days vacationers are looking for more than just a good meal. They want to learn about their food's ingredients, understand how it's made, and even participate in the preparation.

Hotels, restaurants, and cruise lines are responding with innovative programs that offer food enthusiasts unique culinary experiences. From diving for your lobster dinner to cooking alongside your favorite chef, the offerings go beyond conventional cooking classes. "The behind-the-scenes experience is very important," says Jacques-Olivier Chauvin, chief executive of Paris-based Relais & Chateaux, the association of hotels known for fin and accommodations.

The Rosens of Raleigh, N.C., l come ardent culinary travelers years ago, on a vacation in Ita stopped off at Dolada, a Miche star restaurant and hotel in Pieve go north of Venice. They enjoyed so much they extended their stay days and persuaded the chef them to cook specialties such as "We found out cooking as a famil fun," says Alan Rosen, a radiolog

For their next vacation, Rosen wife, Susan Levy, a psychiatrist, al their three children, ages 8, 13, spent a week at a Four Seasons re cooking school in Chiang Mai, T Under the tutelage of chef Pitak they learned to make dishes such thai and banana blossom salad (sons.com/chiangmai).

The Four Seasons and othe chains have been in the forefro trend. Like the Chiang Mai school, which opened in 2003 a $150 a day per person, most of Seasons' 70 properties offer e programs tailored to particular l At the Terre Blanche resort in T in Provence, guests learn the French cooking at nearby La Pi where Julia Child once whipped flés. The Taste of Provence which includes breakfast, one d two, three nights' lodging, and the local market, in addition to t ing school, starts at $1,200.

BEACH BARBECUE

FOR A MERE $3,000 per couple cluding lodging, visitors to the F sons Nevis in the Caribbean part in a new "Dive & Dine" p Available to groups of two to six divers, it features a brief seminar marine life and a private dive w Cyrille Pannier. He instructs g the fine art of lassoing local spin and later cooks up the catch at mate beach barbecue. "The exp we are creating are very muc sponse to that intensified love says Elizabeth Pizzinato, directo porate public relations at Four Hotels Inc., based in Toronto.

At Relais & Chateaux, the cul perience has always been import veys have shown that 83% of gue for the food. Lately its propertie fering fresh options. At Restaurar

IN THIS SECTION:
A Q&A on tech-induced overload
118 For-profit cancer centers gain fans
122 Forex trading for individual investors
124 Plus: Modernism in Savannah

EPICUREAN EXPLORATION

For culinary tourists, the kitchen is the key destination

« THAILAND
Chef Pitak Srichan instructing guests at the Four Seasons in Chiang Mai

SAN FRANCISCO
Halibut entrée at Kuleto's, which has the Chef for a Day program

NEVIS
At the Four Seasons, guests can dive for their lobster dinner

THE HIGH SEAS
Holland America brings leading chefs to do cooking demos

near Cannes in southern France, diners can accompany the chef on his 6 a.m. rounds to the fish market. At Le Manoir aux Quat'Saisons in Oxford, England, travelers can sample rare herbs from the hotel's garden and take home cuttings.

Such culinary flourishes not only make a trip more memorable but also open windows. Epicurean travelers are often looking for an authentic experience. "You can really learn about the culture through the cuisine," says Michael Coon, travel director for the Culinary Institute of America's Worlds of Flavor program, which operates tours of 12 to 18 amateur and professional cooks designed to give an insider's view of Vietnam, Italy, and Mexico, among other places (worldsofflavor.com).

Some cruise ships now have food-show-like kitchens

Cruise line companies are applying that lesson to a mass audience. After extensive research identified food and wine as a growing area of interest among its customers, Holland America Line started equipping each of its ships with state-of-the-art Culinary Arts Centers, similar to the kitchens on food shows, at a price of $1 million each. Through a partnership with *Food & Wine* magazine, the cruise line brings in leading chefs and experts to conduct cooking demonstrations relating to ports of call—margaritas and quesadillas for the Mexican Riviera, seafood stews in the Mediterranean. This season's lineup includes Iron Chef Cat Cora and Aaron Sanchez of New York's Paladar restaurant (hollandamerica.com).

MARITIME MENU

Would-be gourmets can bring that experience home with them. Back in her spacious kitchen in Sacramento, former Chef for a Day Clark still marvels at how the staff at Kuleto's was able to prepare food so meticulously in such cramped quarters. She makes the blood orange salad for her family and hopes to return someday for the early-morning pastry shift.

Rolling dough and prepping vegetables for four hours may not be everyone's idea of a good time. But for more and more foodies, it sounds like the perfect vacation. ■

Zen and the Art of Thinking Straight

Author Ed Hallowell has some solutions for the frazzled and overwhelmed

ARE YOU SUFFERING from any of these symptoms? You frequently feel rushed and impatient, you're easily distracted, you're forgetful, and you have little time for creative thought. If so, Dr. Edward Hallowell, a Sudbury (Mass.) psychiatrist, has a diagnosis: You're probably suffering from environmentally induced attention deficit disorder, brought on by technology and activity overload. Hallowell spoke to Associate Editor Anne Tergesen about the solutions he outlined in his new book, *CrazyBusy: Overstretched, Overbooked, and About to Snap—Strategies for Coping in a World Gone ADD* (Ballantine Books; $24.95).

HALLOWELL

What are the consequences of living in our attention deficit society?

Everybody is trying to do more in less time. People literally channel surf through the day. During conversations, part of our minds are elsewhere. We want to move on. When you gradually take on more and more, it can reach a point where everything, even good things like friendship, starts to feel like a burden. In that mode, you won't function well at work or interpersonally.

Are business people vulnerable?

Yes. They are conditioned to never complain. They want to be good team players. So when they're asked to do more, they suck it up and work har they become so frazzled, they'r joying the work and performa off. It's a safe bet that anyone w and has kids also understands sues. They're juggling deadline rehearsals, and school meetings worrying about how the groce ping, cooki laundry will People want these activit they take than they can ably do. E-m to facilitate scheduling.

What's the so

Do not al world to ha to you 24/7. time to wor you check yo or snail mail mail, before the world t on your fresh cused state Turn off yo Berry and cell phone. Stretch five-minute conversation. Whe down again, you'll be focused.

What else do you recommend?

Prioritizing is crucial. If yo you'll find yourself spread so t only be able to see your good f the first Tuesday in Februa yourself permission to end ships and projects that drain what you're good at and del rest. This is important, becau we do what we're good at, the take on the quality of play. mind that some of our best come when we're doing Downtime is a forgotten art. ■

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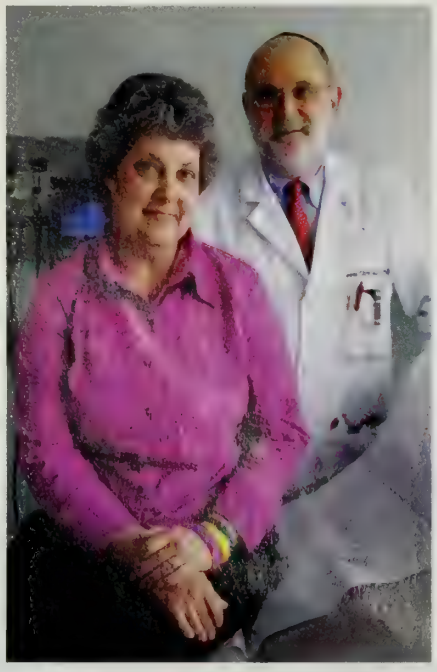
ontact the Georgia Department of Economic Development at 404.962.4006. Visit georgia.org. **Put your dreams in motion.**

An Alternative for Cancer Patients

For-profit treatment centers are competing with community and teaching hospitals. **BY MICHAEL ARNDT**

TEENA PATTERSON WAS diagnosed with inoperable cancer in January, 2004. Thinking she had gallstones, the hairdresser from Council Grove, Kan., went to see her family physician for a sonogram. The doctor discovered her liver was spotted with tumors. For six months, Patterson and her husband, Steve, a truck driver for Frito-Lay, traveled 60 miles each way to Topeka every three weeks for chemotherapy. The drugs shrank the growths, but Patterson lost faith in her oncologist when he told her she asked too many questions.

Then her sister-in-law passed along a videotape she had ordered after seeing a commercial for Cancer Treatment Centers of America (CTCA). Patterson was immediately drawn to its message of holistic healing and personalized care. After confirming that her insurer, Blue Cross & Blue Shield Assn., would cover treatment at the for-profit chain, she was soon on a plane to CTCA's Midwestern hospital outside Chicago for continued chemotherapy and radiation. Patterson, 50, returns to the facility once a month for an infusion of chemotherapy drug Erbitux and a checkup. She still has end-stage cancer. But the tumors appear to be in remission, and she feels good. She credits the CTCA staff. "Their way with people is wonderful," she says. "They really want you to succeed."



IN REMISSION Patterson credits the CTCA staff for her morale and sense of well-being

For years the provider choice for cancer patients has been either a community hospital or a big-name teaching institute. Now there's a third way: for-profit cancer hospitals. Many are local or limited-treatment outfits, such as physician-owned Arizona Oncology Services, which has 11 Phoenix-area clinics that offer only radiation therapy. But Aptium Oncology, a Los Angeles subsidiary of drugmaker AstraZeneca, just opened its ninth outpatient center, in Elizabeth, N.J., giving it properties in four states. U.S. Oncology of Houston, which has 97 facilities in 33 states, boasts that it treats more cancer patients than any other organization in the country.

For many people, particularly those with rare forms of the disease, the medical-school centers remain the preferred option. The National Cancer Institute accredits 39 comprehensive cancer centers in the U.S. Among them: Northwestern Memorial Hospital's Robert H. Lurie Comprehensive Cancer Center in Chicago and the Mayo Clinic in Rochester, Minn.

These giant institutions may t
convenient as the neighborh
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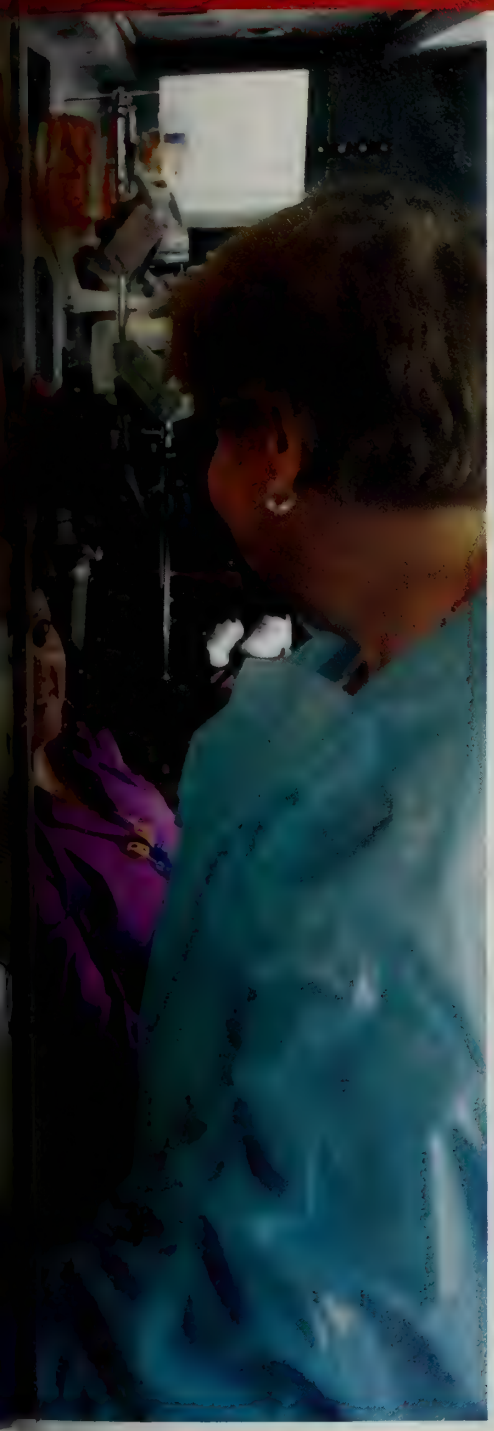


KNOWHOW EDGE A new study says specialist centers often have expertise the all-purpose community hospitals lack

ves ave shown that patients do bet- the their surgeons have performed sa e operations over and over r example, Dr. William J. Cat- , ector of Northwestern's clinical at cancer program, has performed 0 ve-sparing prostate removals, s l doing 25 to 30 a month. "You at r centers and the magnitude of acy and the research, and there's o b some very fundamental differ- " er the for-profit chains, says Pa- J. oldsmith, senior vice-president sin ss development at the National Comprehensive Cancer Network, which represents 19 centers.

Still, a just-published study by health and science consultancy RTI International in Research Triangle Park, N.C., finds that for-profit facilities may be an acceptable alternative. The government-funded report, in the January/February issue of *Health Affairs*, notes that, by their nature, specialist centers often have the expertise and high volumes that all-purpose community hospitals lack. Plus, since they're usually smaller, they can be more personal in patient treatment. "Quality of care is not just dependent on the guy who cuts," says Leslie Greenwald, a senior scientist at RTI and the study's lead author. "It's the nurse who takes care of you and the lab personnel; it's the whole package."

EXPANSION PLANS

OF ALL THE for-profit cancer centers, U.S. Oncology is the biggest and fastest-growing. The company, taken private in a $1.6 billion buyout in 2004, opened five centers last year in partnership with local doctor groups and other investors, increasing its annual revenue to $2.5 billion. Its site in Maplewood, Minn., is typical. One of seven in the Minneapolis-St. Paul area in the Minnesota Oncology Hematology Professional Assn., the facility each week treats roughly 200 outpatients already diagnosed with cancer. Lab work is done on the premises, with results promised in 30 minutes.

The clinic does no surgery, but it offers chemotherapy, including drugs in experimental trials, and radiation treatment. The infusion area is utilitarian: a row of 18 vinyl recliner chairs in a linoleum-tiled room with six TVs suspended from the ceiling and plastic trash cans on the floor. Its radiological equipment, though, includes a state-of-the-art linear accelerator that can zap a tumor from almost any angle with sub-millimeter precision. The machine, from Varian Medical Systems, lists for $5 million. The Minnesota network has two other selling points: Most insurance plans, including Medicare, cover its services, and it is convenient.

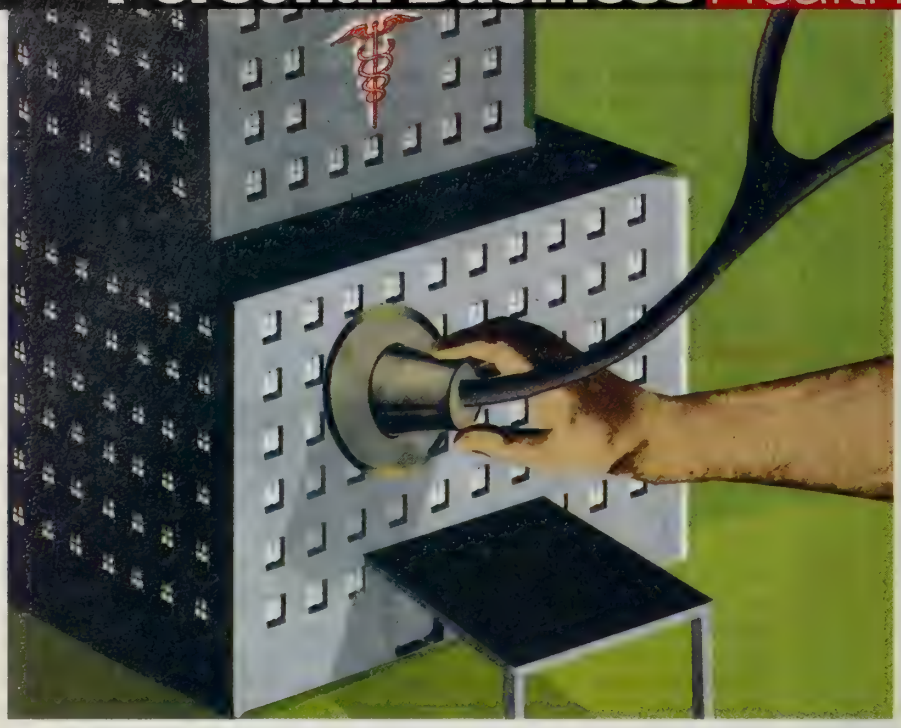
While it's also profit-driven, CTCA is more like a mini-version of Boston's Dana-Farber Cancer Institute than an outpatient-only chain. Its facilities provide chemotherapy, radiation treatment, and stem-cell transplants, but they also have state-licensed hospital rooms. Patients, who travel an average 540 miles one way, can check in and be treated over days if necessary. The centers also have operating rooms and their own oncology surgeons. The company, in Schaumburg, Ill., which began in 1988 with a former community hospital in Zion, Ill., has hospitals in Tulsa and Philadelphia. CTCA has applied for a hospital license in Seattle, where it has an outpatient facility, and plans to expand to Atlanta.

Giant teaching centers point to their R&D advantage

The privately held company eschews physician referrals and advertises to people with late-stage cancer, promising to do almost anything they want to combat the disease. In its Midwestern Regional Medical Center in Zion, the professional staff—radiologists, nutritionists, physical therapists, nurses, pharmacists, a pastor, and even a laughter therapist—meet three times a week to review each patient's condition. In smaller teams, they go from room to room daily to check on patients.

Charges can add up quickly, just as they would at a comprehensive cancer center. Patterson says that after 18 months of treatment at CTCA, including an eight-week stay last summer for radiation and $28,000 a month for her current course of chemotherapy, she is about to max out on her $1 million lifetime coverage through her husband's health-care plan. She is now shopping for a new policy, with higher premiums and deductibles. Still, Patterson has no thoughts about going somewhere else. For her, and for plenty of other cancer patients, the third way is the right way. ■

BusinessWeek online For a table comparing cancer treatment hospitals, go to businessweek.com/extras



Is Your Hospital Heart Healthy?

Before making that appointment with a cardiologist, it pays to do some homework. **BY HOWARD GLECKMAN**

YOU JUST HAD YOUR ANnual physical. Your family doctor says he wasn't happy with your electrocardiogram and wants you to see a cardiologist for tests.

Before you make an appointment, you might want to check out local hospitals to see which rate best at treating heart disease. Why do that? If you eventually need surgery or other intensive treatment, you want to make sure your cardiologist will do the work at a top-ranked facility.

Where do you start? While objective hospital ratings are in their infancy, heart disease is one illness for which the quality of care can be gauged. For instance, it is widely believed that patients with heart disease should be given drugs called ACE inhibitors or ARBs. So hospitals that prescribe them get higher ratings than those that don't.

One good resource is Hospital Compare, operated by the federal Centers for Medicare & Medicaid Services (CMS). It allows you to search local facilities to see how well they treat both heart disease and heart attacks (www.hospitalcompare.hhs.gov). While on the site, compare infection rates, which are a powerful predictor of hospital quality. Avoiding nasty bugs should be a top priority for anyone about to be admitted to a hospital.

> This is one specialty for which quality of care can be objectively rated

The Joint Commission on Accreditation of Health Care Organizations (JCAHO, pronounced Jayco) is another good place to turn. This private, nonprof-

it organization sets standards f care and safety, and certifies and other medical care prov site, jcaho.org, is full of inform though it isn't easy to navigate Quality Check, plug in your zip you'll find a link to your local From there, you can look at an i facility or compare several. hospital, look at how they rate attack care and heart-failure ca

Another national resourc Leapfrog Group (leapfroggr which rates hospitals on a h high-risk procedures, includi bypass surgery. Leapfrog, fu major employers and some does not cover as many hos CMS, in part because it rates o hospitals that volunteer to resp surveys. Hospital Compare, by uses more extensive Medicare formation and other sources. does tell you exactly how ma surgeries are performed at each useful since hospitals that d these procedures tend to have est success rates.

BROADENING THE SEARCH

DR. VINCE BUFALINO, a Naper cardiologist, warns consume careful when they evaluate Take the numerical grades that Compare provides. Patients remember there is no real between a hospital that score one that scores 92, says Bufa sites "should be one bullet poi evaluation."

You can also check your hea er's site. Most now include so ance for choosing a hospital, few provide the detail that you Hospital Compare or JCAHO. surers will rank a hospital in the but not tell you much about wh

Finally, if you do need sur might want to get some information on heart disease treatment. There are plenty informative Web resources, i the American Heart Assn. (a heart.org), WebMD (webmd.c the National Institutes of Heal lineplus.gov).

Rating hospitals for heart c an imperfect process. And info tients may want to know a about the facilities and the s they can learn on the Web. But these sites before you see the gist. Then you'll be prepared to ing your specialist questions.

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The Currency Game: Home Version

Foreign exchange for retail investors? New online trading sites make it affordable. **BY ADRIENNE CARTER**

RODNEY NORMAN LIVES a few miles from the Las Vegas strip. But the 40-year-old independent film producer is not much of a gambler—unless you count his penchant for foreign currency trading. Three years ago, Norman put $250 into an online trading account and doubled that when he became comfortable with price charts and economic indicators. He now spends a few hours a day exploring the market for ideas and has steadily built up the account to about $25,000, betting mainly on the U.S. dollar, Swiss franc, and British pound.

Until recently, foreign currency trading, known as forex or FX, was largely the domain of professional traders and high-net-worth individuals. But many new Web sites now offer accounts with minimums as low as $250, making it affordable for savvy individuals to play. Although there are dozens of sites, it's best to stick with the largest and most established, FOREX.com and FXCM.com

Similar to commodities or options, the forex market is a way to diversify or hedge a portfolio. Since you make money by playing the relative movement of one currency against another, there's no such thing as a bear market in currencies.

But forex is a 24-hour market, and it moves more quickly than the stock market, with currencies sometimes going up, down, and sideways in the course of hours. Indeed, it's not for buy and hold investors. Some 80% of traders are in and out of their positions in a week or less. Given the dynamics, you should play only with money you can afford to lose.

THE STAT

$250

The minimum needed to open a forex trading account

All trades involve pairs of currencies, typically among "the majors": the U.S. dollar, euro, Japanese yen, Canadian dollar, Swiss franc, British pound, or Australian dollar. If you think the U.S. dollar will weaken against the yen, you would sell dollars and buy yen. FX is largely commission free, with the trading cost built into the spread between the bid and ask price. Leverage is also common: If you have $5,000 in a margin account with leverage of 100 to 1, you can buy up to $500,000 of currency. That can your gains and losses.

Let's say you decide the U.S (USD) is undervalued relative to t franc (CHF). In that case, you w dollars and sell francs in anticipa rising exchange rate. The current price for USD/CHF is around 1.28 meaning you can buy $1 for 1.2 Using leverage and putting up $ your $5,000 margin account, you lot—the equivalent of buying $ and selling 129,000 francs.

"IT'S A BRUTAL, BRUTAL WOR

IF THE EXCHANGE rate rises to 1.2940 and you want to realize pr would sell $100,000 and get francs, netting 350 francs. At pr rates, the profit would be around 27% on that $1,000 trade. Conv you were wrong and the rate dr 1.2855/1.2860, you would lose 35%. Should the rate continue to margin account could be wiped

Currently, some investors, i Warren Buffett, are betting aga U.S. dollar in light of a rising cu count deficit. Pros are bullish Canadian dollar. The country ha count surplus and is benefitin strength in the oil market.

Even though currency traders long-term macroeconomic tre short-term nature of FX means heavily on technical analysis. Th price charts to forecast which di currency is headed. They also p attention to economic indicators gross domestic product, nonfa rolls, and housing starts.

Forex is a global minefield that up some of the smartest minds, Buffett of late. "It's a rush bec market moves so quickly," says T. senior currency strategist at RB Markets. "But it's a brutal, brutal As such, a disciplined trading strat entry and exit points is critical. and limit orders help keep trades range and curb losses. It's worth trades at an online demo, availabl e-brokers, before putting money

Newcomer HedgeStreet offer products known as Hedgelets th make daily or monthly bets on the relation to the euro, pound, fran (hedgestreet.com). There is no and the Hedgelets limit potenti and gains—between $0 and $50 tract. Prices are reasonable; Hed charges $1.50 for the first 30 con forex makes you nervous, this is what tamer way to trade in curre

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EDITED BY MONICA GAGNIER

TIME OFF

MODERNISM MEETS THE OLD SOUTH

THE INSTITUTION THAT bills itself as the oldest public art museum in the South has just opened a modern glass-and-stone edifice designed by Israeli-Canadian architect Moshe Safdie.

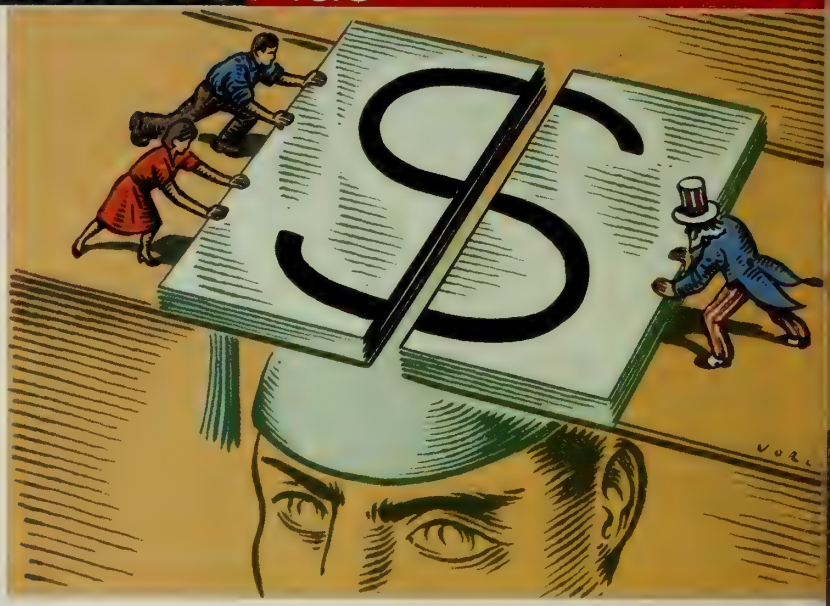
Known as the Jepson Center for the Arts, the 64,000-square-foot building marks the first expansion in the 119-year history of Savannah's Telfair Museum of Art. The $30 million facility adds 66% more space to the museum's two National Historic Landmark buildings in the Georgia city's historic district.

JEPSON CENTER Snazzy new look

Among the features of the Jepson Center are two large spaces for major traveling exhibits, a hands-on gallery for young people, a 200-seat auditorium, two outdoor sculpture terraces, a café, and a store (telfair.org).

In the Jepson's inaugural exhibits, you can view recent assemblages and collages by Robert Rauschenberg, as well as a tribute to Savannah's artistic heritage. The Rauschenberg show runs through June 4, while the Savannah exhibit closes May 14.

Also on display through May 21 is the Kirk Varnedoe Collection, 20 works on paper by such contemporary artists as Frank Stella, Richard Serra, and Jeff Koons. The collection is a gift from sculptor/photographer Elyn Zimmerman in memory of her husband Varnedoe, a Savannah native who was a curator at the Museum of Modern Art.



COLLEGE SAVINGS PLANS

On Equal Footing

SAVING FOR COLLEGE via prepaid plans that allow parents to lock in tuition at to rates has always had a big drawback: Every dollar in the plan can cost parents students a dollar of financial aid. On the other hand, every $1 in a Section 529 college savings plan—which allows parents to invest money that grows tax-fre provided it's used for schooling—only knocks 5.6¢ off of financial aid.

In a recently passed budget bill that goes into effect on July 1, Congress put two types of college savings plans—prepaid and savings—on equal footing. As result, families will lose only 5.6¢ in aid for every dollar in each kind of accoun

Of the 19 prepaid plans on the market, 18 are sponsored by states. The othe privately backed Independent 529 Plan, which locks in today's tuition at 255 participating private universities, including Princeton and Rice. Many state pr require the beneficiary or account owner to be a resident of the sponsor state. student opts for a private or out-of-state school, many pay out the equivalent c average in-state public college tuition. *–Anne T*

THE OTHER RED MEATS

IF YOU LOVE beef, but not the fat and calories, try the lean r meats popping up at specialty food stores. D'Artagnan rece began distributing buffalo, ostrich, and venison to gourmet grocers. They are higher in protein than beef and much low fat (table). Buffalo tastes the most like beef, while venison i more gamy and ostrich is a bit sweet. Your only beef might the price. Buffalo tenderloin is about $35 per pound, vs. $17 for the same cut of top-of-the-line prime beef. *–Lauren Young*

3.5 OZ. SERVING (COOKED)	CALORIES	FAT	CHOLESTEROL	PROTEIN	PI
Buffalo	143	2.4g	82mg	28.4%	$.
Ostrich	140	2.8	65	26.9	
Prime Beef	255	15.3	86	27.5	
Venison	150	2.4	79	30.0	

Data:

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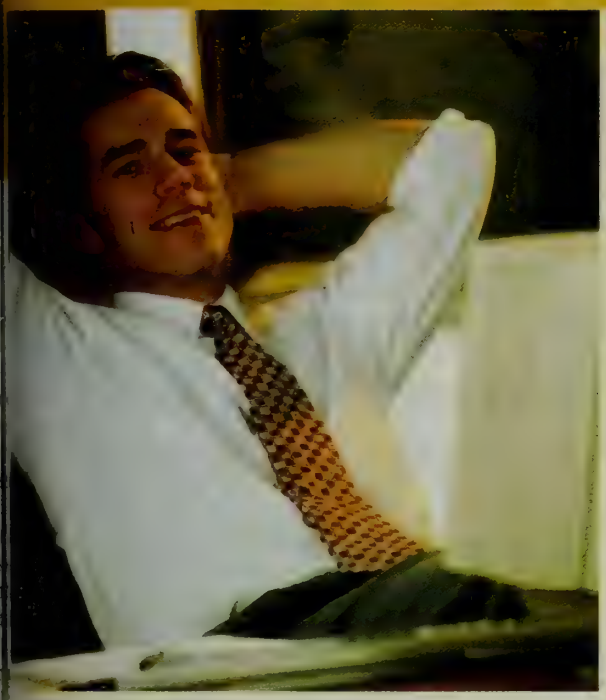

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BY GENE G. MARCIAL

HEALTHIER VITTLES LURE SHOPPERS INTO SAFEWAY'S AISLES.

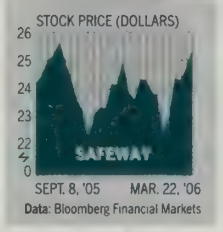
BOB EVANS FARMS HAS BEEN SERVING UP HEFTY GAINS LATE

WILL OPPONENTS BLOCK A BUYOUT AT DRUGMAKER ANDRX?

Safeway: On Safer Turf

AFTER THREE YEARS of sluggish sales and crimped earnings, Safeway (SWY) is back. The supermarket chain was "sailing in treacherous waters," says Hitesh Kuvelkar, an analyst at investment firm First Global, but has "recovered smartly." In 2005's fourth quarter, earnings jumped 15% on a sales rise of 7.2%. Safeway's stock, up from 22 in mid-February to 25.33 on Mar. 22, should outperform the market, says Kuvelkar. "We see substantial upside" from the current price, he says. What impresses Kuvelkar is Safeway's focus on operating margins, which have leaped from 1.6% in 2004 to 3.3% in 2005, and are estimated to hit 3.9% for the year 2006. That will translate into operating earnings of $1.64 a share in 2006, Kuvelkar figures, compared with $1.40 in 2005. The key to the chain's improved margins is keeping costs down in the face of rising fuel prices, he says. Safeway has also seen sales volume improve, thanks to its new "lifestyle" format at many of its 1,800 stores. The campaign offers better-quality products, such as natural and organic foods, and greets customers with a more pleasant store environment, according to analysts. Joseph Agnese of Standard & Poor's, who rates Safeway a "buy," lauds the improving sales trends, and he also points to restructured union contracts that will stabilize labor costs. Agnese says Safeway's valuation will improve as it continues to recover the business it lost after the September, 2004, strike in California.

BOUNCING RIGHT UP

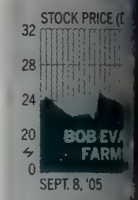


Data: Bloomberg Financial Markets

The Right Recipe At Bob Evans

INVESTORS ARE digging into shares of casual-dining operator Bob Evans Farms (BOBE), whose stock has popped from 22 in November to 29.89 now. "Its recipe for a turnaround appears solid," says David Sowerby, portfolio manager at investment firm Loomis Sayles, which owns shares. Sales at Bob Evans' 585 family-style restaurants in 19 states are on the rise. Profits in its most recent quarter nearly doubled from a year ago, owing to cost cutting, less price discounting, more advertising, and an improved menu. The company, with little Street coverage, beat earnings forecasts in the two previous quarters, notes Sowerby. He sees Bob Evans, which also makes sausages and other food products, sustaining its double-digit earnings growth next year, with the stock hitting 38. Jonathan Waite of KeyBanc Capital Markets, who tags the stock a "buy," forecasts earnings of $1.21 a share in 2006 (ending Apr. 30) and $1.45 in 2007, compared with $1.04 in 2005. He says the real upside will come from sales and fundamental improvements.

A NICE SIZZLE

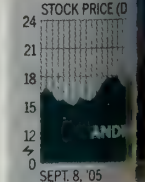


Data: Bloomberg Fin

Andrx: Many Hurdles Before the Deal Is Done

GENERIC-DRUG MAKER ANDRX (ADRX) agree Mar. 13 to be acquired by Watson Pharmaceuti No. 3 in generics, for $1.95 billion, or 25 a shar cash. But MMI Investments, the biggest stakeholder, 12.3%, plans to oppose the deal, which is still awaiting regulatory approval, and others could follow suit. Hou before the announcement, MMI had bought 420,000 at 20.96 to 21.60 apiece. When the news broke, "I was shocked," says MMI President Clay Lifflander, who ha buying almost weekly since December. Shareholders usually are overjoyed when a buyout takes place. But Lifflander says the timing is bad. In early September, the Food & Drug Administration halted the approval of new Andrx generics, estimated to have market potential of $2 billion, over questions on the Andrx production facilities. Lifflander says the FDA may lift the ban after another plant inspection. When that happens, the value of Andrx will skyrocket, he says, and the stock, now at 23.69, could be worth 40 in 12 t months. "Andrx will have to convince me about the d advantage to shareholders." Amy Stevens of Susqueh Financial Group, who rates Andrx "neutral," says "it a possibility the deal won't go through."

INVESTOR HOPES AR



Data: Bloomberg Fin

BusinessWeek online Gene Marcial's Inside Wall Street is p businessweek.com/investor at 5 p.m. EST on the magazine' publication day, usually Thursdays.

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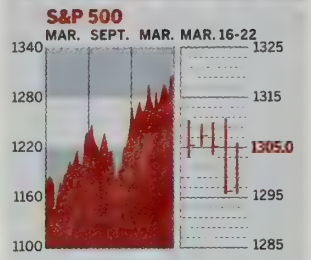
Personal Business Figures of the Week

STOCKS



COMMENTARY

The markets had a mixed showing as some blue-chips reported better-than-expected profits. Among the winners: Home Depot, JPMorgan Chase, and Marathon Oil. The gains pushed the Dow Jones industrial average to 11,317.4, a gain of 1% for the week. The Standard & Poor's 500-stock index rose 0.2%, and the tech-laden NASDAQ Composite fell 0.4%.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	MAR. 22	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1305.0	0.2	4.5	11.4
Dow Jones Industrials	11,317.4	1.0	5.6	8.1
NASDAQ Composite	2303.4	−0.4	4.4	15.8
S&P MidCap 400	781.3	−0.1	5.9	18.6
S&P SmallCap 600	386.5	1.0	10.2	19.4
DJ Wilshire 5000	13,131.1	0.1	5.1	13.5
SECTORS				
BusinessWeek 50*	769.4	−0.1	3.7	10.3
BW Info Tech 100**	392.9	0.2	3.3	13.0
S&P/Citigroup Growth	615.7	0.2	3.2	8.8
S&P/Citigroup Value	686.0	0.1	5.9	14.0
S&P Energy	395.0	−0.9	6.0	16.1
S&P Financials	444.5	0.4	4.2	17.1
S&P REIT	173.7	−0.7	13.5	31.8
S&P Transportation	275.9	0.5	10.4	22.0
S&P Utilities	160.6	−1.3	0.6	10.4
GSTI Internet	190.0	0.2	−7.4	23.8
PSE Technology	872.0	−1.1	4.3	20.5

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	MAR. 22	WEEK	YEAR DA
S&P Euro Plus (U.S. Dollar)	1680.4	1.2	1
London (FT-SE 100)	6007.5	0.7	[illegible]
Paris (CAC 40)	5194.8	1.3	1[illegible]
Frankfurt (DAX)	5932.3	0.6	[illegible]
Tokyo (NIKKEI 225)	16,495.5	1.1	[illegible]
Hong Kong (Hang Seng)	15,642.8	−0.5	[illegible]
Toronto (S&P/TSX Composite)	11,970.7	−0.7	[illegible]
Mexico City (IPC)	19,598.1	3.1	1[illegible]

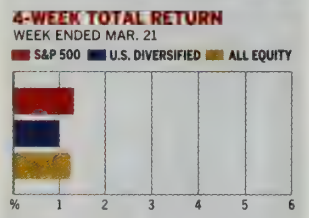
FUNDAMENTALS	MAR. 21	WEEK AG
S&P 500 Dividend Yield	1.78%	1.78%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.0	18.0
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	15.1
First Call Earnings Revision*	0.08%	−0.67%

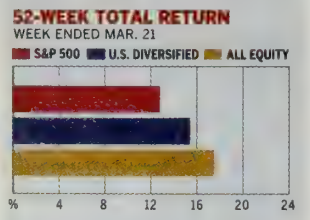
TECHNICAL INDICATORS	MAR. 21	WEEK AG
S&P 500 200-day average	1239.5	1236.9
Stocks above 200-day average	66.0%	67.0%
Options: Put/call ratio	0.69	0.74
Insiders: Vickers NYSE Sell/buy ratio	5.47	5.46

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Agricultural Products	13.6	Specialized Finance	59.1
Steel	12.7	Oil & Gas Refining	58.2
Constr. Materials	10.1	Human Rsrcs. & Emplmt.	56.2
Distillers & Vintners	9.0	Oil & Gas Equip.	55.4
Divsfd. Commercial Svcs.	8.8	Constr. Materials	52.5

WORST-PERFORMING GROUPS	LAST MONTH %	
Spclzd. Cnsmr. Serv.	−17.3	Automobiles
Gold Mining	−16.3	Motorcycles
Educational Services	−9.9	Broadcasting
Homebuilding	−9.5	Diversified Chemica
Semiconductor Equip.	−7.9	Home Furnishings

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Japan	5.1	Latin America	76.5
Diversified Pacific/Asia	4.5	Precious Metals	48.1
Real Estate	3.5	Diversified Emerg. Mkts.	44.1
Foreign	3.5	Japan	34.0
LAGGARDS		**LAGGARDS**	
Precious Metals	−2.6	Domestic Hybrid	9.5
Natural Resources	−2.6	Miscellaneous	10.9
Utilities	−1.3	Large-cap Blend	12.5
Latin America	−0.9	Large-cap Value	12.6

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
American Heritage	12.5	ProFunds Ultra Japan Inv.	91.2
ProFds. Sh. Prc. Mtls. Inv.	9.2	ING Russia A	86.3
Eaton Vance Grtr. India A	8.3	T. Rowe Price Latin Am.	79.9
Turnaround	7.9	Fidelity Latin America	76.8
LAGGARDS		**LAGGARDS**	
Ameritor Investment	−16.7	Ameritor Investment	−68.8
ProFunds Prc. Mtls. Inv.	−13.7	American Heritage Grth.	−33.3
Rydex Precious Metals	−5.9	Potomac Sm. Cap/Sh. Inv.	−32.0
AIM Gold & Prc. Mtls. Inv.	−5.5	ProFds. USh. Sm. Cap Inv.	−30.6

INTEREST RATES

KEY RATES	MAR. 22	WEEK A
Money Market Funds	4.13%	4.09
90-Day Treasury Bills	4.68	4.61
2-Year Treasury Notes	4.74	4.68
10-Year Treasury Notes	4.70	4.73
30-Year Treasury Bonds	4.72	4.75
30-Year Fixed Mortgage †	6.25	6.28

†Bar

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND
General Obligations	3.93%
Taxable Equivalent	5.61
Insured Revenue Bonds	4.00
Taxable Equivalent	5.71

THE WEEK AHEAD

FOMC MEETING *Tuesday, Mar. 28, 9 a.m. EST* » The Federal Reserve's Open Market Committee meets for two days to discuss monetary policy. This will be the first meeting for new Chairman Ben S. Bernanke. The unanimous view among economists surveyed by Action Economics is that the central bank will move the fed funds rate up, from 4.5% to 4.75%.

CONSUMER CONFIDENCE *Tuesday, Mar. 28, 10 a.m., EST* » The Conference Board's March consumer confidence index most likely edged up to 102 after easing to 101.7 in February. Consumer expectations about future economic conditions drove the February decline.

PERSONAL INCOME *Friday, Mar. 31, 8:30 a.m. EST* » Personal income probably increased 0.4% in February after a healthy gain of 0.7% in January. Consumer spending is forecast to have ticked up 0.1% in February. January spending shot up 0.9% on stronger auto sales and balmy temperatures.

FACTORY INVENTORIES *Friday, Mar. 31, 10 a.m. EST* » Manufacturing inventories most likely rose by 0.2% in February. In January, inventories grew by 0.5%. The inventory-to-sales ratio remains at a record low, which should prompt some additional factory activity.

The BusinessWeek produc eased to 269.4 for the we Mar. 11 but stood 12.9% year-ago level. Before calc the four-week moving ave index inched up to 269.1.

BusinessWeek

For the BW50, more inve data, and the componen of the production index v www.businessweek.com/magazi

f You Can Read This Chart, 'ou Will Have 20/20 Vision.

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Stock Reality Check: What's worth investing in as the market trades near six-year highs?

Top Performers: Who made the cut this year on BusinessWeek's list of the top 50 companies?

Tax Time: We test tax-prep software and offer tips to save you money.

Make-Ahead Meals: Meal-assembly businesses are hot. Learn how to operate your own storefront kitchen.

Toy Tryouts: Inventors vie for a spot on FAO Schwartz's shelves.

BusinessWeek weekend

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The Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A
ABC (DIS) **42**
ACNielsen **44**
Adidas Group **106**
Adobe (ADBE) **68**
Aetna (AET) **32, 64**
A.G. Edwards (AGE) **70**
AIG (AIG) **30**
Airbus **76**
Airwide Solutions **55**
Alienware **30**
Al Jazeera **42**
Allianz (AZ) **72**
Alvarez & Marsal **108**
American Express (AXP) **72**
American Technology **68**
Amgen (AMGN) **64**
Andrx (ADRX) **126**
Apple (AAPL) **36, 54, 64, 68, 82, 106, 134**
AppRiver **16**
Ashland **94**
AstraZeneca (AZN) **118**
Atticus Capital **50**
Aviva **30**
Azure Capital **56**

B
Bain Capital **90**
Baker Hughes (BMI) **64, 70**
Bank of America (BAC) **14, 32, 48**
Barclays (BCS) **27, 48**
Bertelsmann **44**
Best Buy (BBY) **64**
Bob Evans (BOBE) **126**
Brio **44**
Bristol-Myers (BMY) **43, 88**
BSkyB (BSY) **42**
Burlington Northern (BNI) **78, 85**

C
Calix Networks **56**
Capital IQ (MHP) **78**
Caterpillar (CAT) **100**
CBS (CBS) **14**
Chevron (CVX) **93**
Christophe **64**
CIBC World Markets **72**
Cinergy (CIN) **43**
Cingular Wireless **24**
Cisco (CSCO) **32**
Citigroup (C) **30, 48, 134**
CLSA Asia-Pacific **22**
CNN (TWX) **42**
Coca-Cola (KO) **43**
CoffeeCup Software **13**
Comcast (CMCSA) **42**
ConocoPhillips (COP) **70, 93**
Content Idea of Asia **113**
Corporate Library **38**
CreditSights **72**
Credit Suisse (CSR) **30, 34, 56, 74**
Crown Castle (CCI) **54**
CVS (CVS) **64**

D, E
Dell (DELL) **24, 30, 64, 68**
Delphi (DPHIQ) **30**
Deutsche Bank (DB) **83**
DHL International **76**
DirecTV (DTV) **42**
Dow Jones (DJ) **30**
D.R. Horton (DHI) **64, 74**
DTG **44**
Dubai Ports World **134**
DuPont (DD) **43**
eBay (EBAY) **44, 45, 96**
EchoStar (DISH) **42**
Edward Jones **76**
Electronic Arts (ERTS) **64**
Eli Lilly (LLY) **43**
Endesa **72**
Endpoint Technologies **68**
Enron **34, 134**
Ethos Water (SBUX) **10**
ExxonMobil (XOM) **93**

F, G
FedEx (FDX) **32, 64, 76**
Fifth Third (FITB) **38**
First Global **126**
Four Seasons (FS) **114**
Gas Natural SDG **72**
Gilead Sciences (GILD) **88**
Glass Lewis **38**
GM (GM) **30**
Goldman (GS) **64, 72, 78**
Google (GOOG) **13, 30, 32, 36, 54, 96, 106**

H, I
Halliburton (HAL) **70, 78, 84**
Heavy.com **26**
HedgeStreet **122**
Hewitt Associates **18**
Holland America Line **114**
Home Depot (HD) **16, 48, 64**
IBM (IBM) **48, 52, 68**
IDC **54**
iFilm.com **26**
Intel (INTC) **32, 54**
Intelligent Results **48**
ISS **38**
iSuppli **22**

J, K
J&J (JNJ) **43**
Javelin Group **106**
J. D. Power (MHP) **74**
JMP Securities **56, 74**
JPMorgan Chase (JPM) **78**
KeyBanc Capital **126**
KeyCorp (KEY) **48**
Kingdom Holdings **134**
Kleiner Perkins **56**

L, M
Lennar (LEN) **64, 74, 97**
Lenovo **24**
LNR Property **97**
Loomis (LSBRX) **126**
Lowe's (LOW) **64**
Lukoil **93**
Lumene **64**
Marathon (MRO) **94**
McGraw-Hill (MHP) **78**
MediaFLO (Q) **54**
MediaVest USA **26**
Mercer (MMC) **64**
Merrill Lynch (MER) **30, 32**
MetLife (MET) **30**
Micron (MU) **22**
Microsoft (MSFT) **30, 32, 36, 48, 52, 54, 56, 78**
Mitsubishi Tokyo **46**
Mitsui Sumitomo **30**
MMI Investments **126**
MobiTV **54**
Modeo **54**
Morgan Stanley (MS) **43, 45, 76**
Motion Computing **76**
Motivation Worldwide **110**
MSN (MSFT) **36**
MySpace (NWS) **106**

N, O
National Oilwell Varco (NOV) **64**
Needham **68**
Nike (NKE) **106**
Nintendo (NTDOY) **52**
Nokia (NOK) **54, 90**
Norsk Hydro ASA **70**
Nvidia (NVDA) **34, 78**
NYSE (NYX) **72**
Occidental (OXY) **83**
Oracle (ORCL) **56**
Ovum **55**

P, Q, R
Pall (PLL) **18**
P&G (PG) **72**
PayPal (EBAY) **48, 96**
PepsiCo (PEP) **43**
Pfizer (PFE) **32**
Phelps Dodge (PD) **50**
Pixar (DIS) **82**
Plaatsdale Investment **18**
PricewaterhouseCoopers **54**
Prosper.com **48**
Prudential **30**
Prudential Financial (PRU) **78**
Publicis (PUB) **55**
Pulte Homes (PHM) **74**
Punk Ziegel **38**
Qualcomm (Q) **54**
RBC Capital **55, 122**
Roche (RHHVF) **88**
RTI International **118**

S
Safeway (SWY) **12**
Samsung **22, 64**
S&P (MHP) **72, 78**
SAS **48**
Schering-Plough (
Schlumberger (SL
Seagate (STX) **110**
Shell (RD) **70**
SJ Consulting **76**
Skype (EBAY) **96**
SME Capital Mark
Smith Barney (C)
Softbank **30**
Sony (SNE) **52**
SourceCode **56**
Sport Otto **44**
Sprint Nextel (S)
Staples (SPLS) **4**
Starbucks (SBUX) **64**
St. Paul Travelers
Sumitomo Mitsui
Sumitomo Trust **4**
Susquehanna Fin **126**
Symantec (SYMC)

T, U, V
TaoBao **45**
TBWA\Chiat\Day
TeamBuilding **110**
Texas Instruments **78, 90**
Thomson (TOC)
Time Warner (TW
Toodou **45**
Toshiba (TOSBF)
Toys 'R' Us **32**
Tyson Foods (TSN
UAL (UALAQ) **32**
UBS (UBS) **34**
UFJ **46**
USVP **32**
Varian Medical (V
Verizon Wireless
Viacom (VIA) **26**
Vodafone (VOD)

W, Y, Z
Wachovia (WB) **4**
Wainright Bank (W
Wal-Mart (WMT) **64**
Walt Disney (DIS)
Washington Mutu
Watson (WPI) **12**
Weatherford (WF
Yahoo! (YHOO) **3**
youtube **26**
Zend Technologie
Zensho Consultin
Zurich Financial

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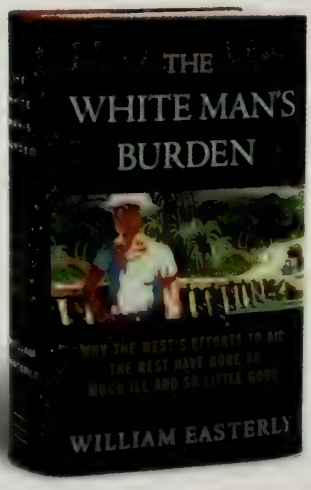
Throwing Money–and Missin

THE WHITE MAN'S BURDEN **Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good**
By William Easterly; Penguin Press; 436pp; $27.95

The international development community is still reeling from William Easterly's 2001 book, *The Elusive Quest for Growth*. In it, the former top World Bank economist demonstrated how the panaceas concocted by the West to save the Third World, such as huge injections of aid, conditional loans, population control, infrastructure spending, and debt forgiveness, have all failed to stimulate sustainable growth and cut poverty.

Easterly is at it again. In *The White Man's Burden*, he marshals a wealth of fresh studies, original statistical analyses, his own anecdotal reporting, and historical precedents to buttress his argument that today's foreign-aid system doesn't work. He shreds practically every new strategy by the World Bank, International Monetary Fund, U.N. agencies, and other donors aimed at lifting the world's poor out of misery. This book is disappointingly skimpy on solutions, but it is brilliant at diagnosing the failings of Western intervention in the Third World.



The real tragedy, says Easterly, isn't Western indifference toward the human crises in Africa and elsewhere, as many advocates of huge aid hikes claim. The problem is the development community's miserable record of treating the most basic needs of the poor. The West "spent $2.3 trillion on foreign aid over the past five decades and still has not managed to get 12¢ medicines to children to prevent half of all malaria deaths." Throwing greater sums at the problem under the existing system will actually be detrimental because "the current wave of enthusiasm for addressing world poverty will repeat the cycle of its predecessors: idealism, high expectations, disappointing results, cynical backlash." So before digging further into their wallets, rich donors should demand hard results and hold international aid agencies accountable.

Easterly's 16 years as a World Bank economist and his broad experience in developing nations make the critiques hard to dismiss. He is as harsh on U.S. conservatives as on free-spending liberals. He blasts the Bush Administration's antipoverty programs as naive and poorly conceived. He rips into the President's much-ballyhooed African AIDS initiative because it focuses mainly on expensive drugs while discouraging the use of condoms, whose widespread application could save many more millions of lives. He also ridicules neoconservatives who believe the U.S. can make poor failed states better places by forcibly removing dic and imposing democracy and free-market economics.

Yet the author admits he has no big answers of his o fact, he says he's allergic to anything smacking of ambi planning. The fatal flaw of big aid initiatives, he writes, they derive from rich Westerners' utopian agendas rath than input from the needy. Another problem with broa collective goals is that no one agency bears responsibili achieving anything concrete.

Instead, Easterly advocates "piecemeal intervention instance, donors should fund well-focused projects cre "seekers," highly motivated individuals wh creative ways to solve real-world problems profiles many grass-roots success stories th deserve help, from a private college in Gha an Indian outfit that cut HIV incidence by working with prostitutes. Aid agencies sho focus on specific tasks, such as building ro clinics or providing textbooks. Independer auditors should scrutinize sample projects field to see if they are delivering results. Po villagers ought to decide for themselves wh they need, receive cash vouchers supplied donors, and use these to hire the most effe agencies to provide what's wanted.

These are great ideas. But would hundr thousands of independent microprojects r make a bigger impact—or be more cost-eff and freer of abuse—than if such efforts we coordinated through exis channels? More to the po well-off, conscientious Westerners are unlikely t and watch millions of Af die of preventable causes they wait for verifiably w free aid projects to mater

Easterly nails how Western aid fails to cut poverty, but he's short on solutions

Easterly's book also ha glaring omissions. What t for example, of the imme foundations guided by ty such as Bill Gates that ain bring the focused, results methods Easterly advocates into the war on AIDS, tuber malaria, and other diseases? Nobody would label Gates planner, but he does believe in international coordinatio goals, and big expenditures. Surprisingly, the Bill & Meli Gates Foundation isn't mentioned in this book.

Easterly's thesis may be overstretched. Still, he is rig we should be tough on aid agencies that don't deliver. *White Man's Burden* is disturbing but essential readin would-be Samaritans—and a powerful call for reform.

–By Pete E

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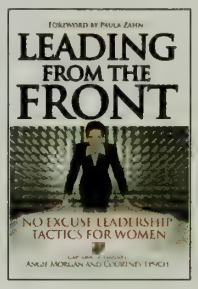

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WITH MARIA BARTIROMO

For Citi, 'No More Excuses'

SAUDI PRINCE ALWALEED bin Tal Al-saud, with a net worth estimated at almost $21 billion, is one of the world's richest men. But he is no passive prince, sitting back while the oil billions roll in. Alwaleed, 48, is an active investor, with stakes in Apple, Disney, Citigroup (with some $10 billion invested), and others. On Mar. 17 he announced that he would float an initial public offering for 30% of his holding company, Kingdom Holdings. The Prince, who was in Riyadh and spoke with me by phone, is a savvy businessman and a close observer of Middle East politics.

Lets talk about one of your big holdings, Citigroup. Several of the company's largest holders have recently been net sellers. What does [CEO] Chuck Prince need to do?
I met with Sandy Weill and Chuck Prince a month ago at the George V Hotel in Paris, and we discussed the promise from Chuck that he will deliver good results. If I can quote him, he said: "Prince, we have put the big problems of Citi behind us, and we have to move our shares to above 50."

So how long a grace period are you giving Chuck Prince?
The grace period is over. You can quote me on that. Right now we are looking to the results in the next few weeks and...I have full confidence that [Citi] will deliver. This is the No. 1 company in the world. It has equity of $400 billion and assets of $1.4 trillion. So no more excuses....Excuses are finished. Now we are at war. Citigroup has won the internal war by cleaning up all the Enron residuals, WorldCom, the European scandal. Now we have to win the external war...make good investments...and that should lift the price of the stock. That's it. I told him, as [Citi's] biggest shareholder, we have to win the external war. Thank you, Mr. Chuck Prince. Now, the Prince of Saudi Arabia tells the Prince of New York: Go to war, and I am backing you 100%.

Do you think the U.S. is taking a turn toward protectior ?
Let's not read too much into the Dubai Ports situation: ngnore went into protectionist mode, but President Bush was ling let the deal go through. If this is an isolated incident, en But if the U.S. discourages foreign investment, then v an an impact. Obviously the U.S. cannot afford to close i ordi to debt and equity since foreigners are financing its del The action was not positive. Arab investors did not like the and they are monitoring it very closely.

What kinds of investments may go elsewhere?
Already we are seeing a lot of money coming back to S bia and being kept in the system. If the U.S. Administr Congress keep vetoing foreign in obviously foreigners will go sc else. But I don't think it will happ we will see open deals.

You have asked the Saudi governm to make some changes to enable inve there. Do you think it will happen?
The problem is that foreigners a lowed to invest in the Saudi m though they are allowed to invest held by banks. Saudi Arabia has to ing parts of its holdings to the pu not hold 70% of everything. They foreigners invest in Saudi stocks. to continue to encourage the proce And they have to expedite the p teaching the public how to invest.

Let's talk about Iraq. What will be t of a civil war in Iraq?
In Iraq, what you are seeing is destabilization of the situation ar ginning of, God forbid, the seeds of tween the Shiites and the Sunnis that could destabilize region. Remember, you have Shiites all over the r Kuwait, Lebanon, Jordan.... So it's a very serious situ though we are not happy to have [U.S.] troops in Irac too early for the U.S. to pull out.

What do you make of Hamas' victory in the Palestinian t
Honestly speaking, people look at it negatively, but I think that Hamas will come into the political system could compare] Hamas to the IRA in Ireland.

Maria Bartiromo is the host of CNBC's Closing Bell.

'If you see money in your code, you want to protect it. If you don't, then you want it liberated."

– Dana Blankenhorn, ZDNet Open Source Blog

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IdeasOutside Shot

BY DAVID HUETHER

The Case of the Missing Jobs

Manufacturing in America is producing and exporting more goods tha ever before. In 2004 and 2005, manufacturing's expansion easily outpa that of the larger U.S. economy. Yet after losing 1.5 million jobs during 2001 recession, manufacturing has shed another 1.5 million workers— as the rest of the economy has since added more than 5 million new job

What's going on here? Why is manufacturing employment, at 14.2 million workers, at its lowest level in more than 50 years while manufacturing output is at an all-time high?

Some blame the outsourcing of American factory jobs to rapidly industrializing low-cost countries such as China and India. Others fault our growing trade deficit. And some posit that the current manufacturing recovery has not generated as robust a demand for U.S. goods as have previous post-recession upturns. But none of these interrelated factors has influenced manufacturing employment nearly as much as has continuously strong productivity growth.

Since 2001, with the aid of computers, telecommunications advances, and ever more efficient plant operations, U.S. manufacturing productivity, or the amount of goods or services a worker produces in an hour, has soared a dizzying 24%. That's 72% faster than the average productivity advance during America's four most recent recession-recovery cycles dating back to the 1970s. In short: We're making more stuff with fewer people.

U.S. manufacturing has for decades been the world leader in the productivity gains that drive living standards higher. But more recently, practically every manufacturing economy around the globe has posted strong productivity gains and experienced job losses as a result. Although you'll never hear it reported by protectionist pundits, China has actually lost more manufacturing jobs than America since 2000, with 4.5 million jobs gone vs. 3.1 million in the U.S. Among the top 10 industrialized economies (the U.S., Japan, Germany, China, Britain, France, Italy, Korea, Canada, and Mexico), which represent 75% of world manufacturing output, only Italy managed not to lose factory jobs since 2000.

It's certainly true that U.S. manufacturers face stiff competition in low- and mid-tech products from increasingly capable global rivals. Our trade deficit is a reflection of those competitors' collective capacity to deliver affordable consumer products to America and other internationa markets. But it's also true that persistently slow econo growth in Japan and Europe has limited demand for U made goods and thus worked to lower post-recession from American plants, as did the uncertainties caused September 11 attacks, corporate scandals, and the buil war in Iraq during the early stages of our current expa

So, contrary to popular belief, it has been this lower demand and output, coupled with high productivity g that has conspired to depress the kind of manufacturi creation we might otherwise have expected since 2002

U.S. manufacturing output has increased a welcome since the end of 2001. [It continues to gro page 27.] But that growth is barely half th average increase during the initial four ye the previous four recoveries. Remember, manufacturing productivity has increase significantly faster than in earlier recoveri don't have to be an economist to see how combination of far slower output growth much higher productivity has been very b employment. Indeed, if manufacturing o and productivity growth rates during the recovery had equaled those averaged duri previous four upturns, U.S. manufacturin have created 3 million more jobs than it h employment would have recovered to its recession level of 17.2 million by the end o

> Slower output growth and sizzling productivity have curbed factory job creation

Fortunately, demand for American-made products increased, and manufacturing's output has grown at a 4.8% annual pace during the past two years. Because figure almost matched manufacturing's 5.1% producti growth, factory employment has remained relatively s But U.S. manufacturers aren't about to invest any less productivity improvements in future years. Internatio competition won't let them. Looking ahead, the numb manufacturing jobs we create or lose will depend enti the global demand for U.S.-made products.

David Huether *is chief economist at the National Associ Manufacturers.*

Views expressed in Outside Shot are solely those of contributors.

ss Week
April 10

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BusinessWeek

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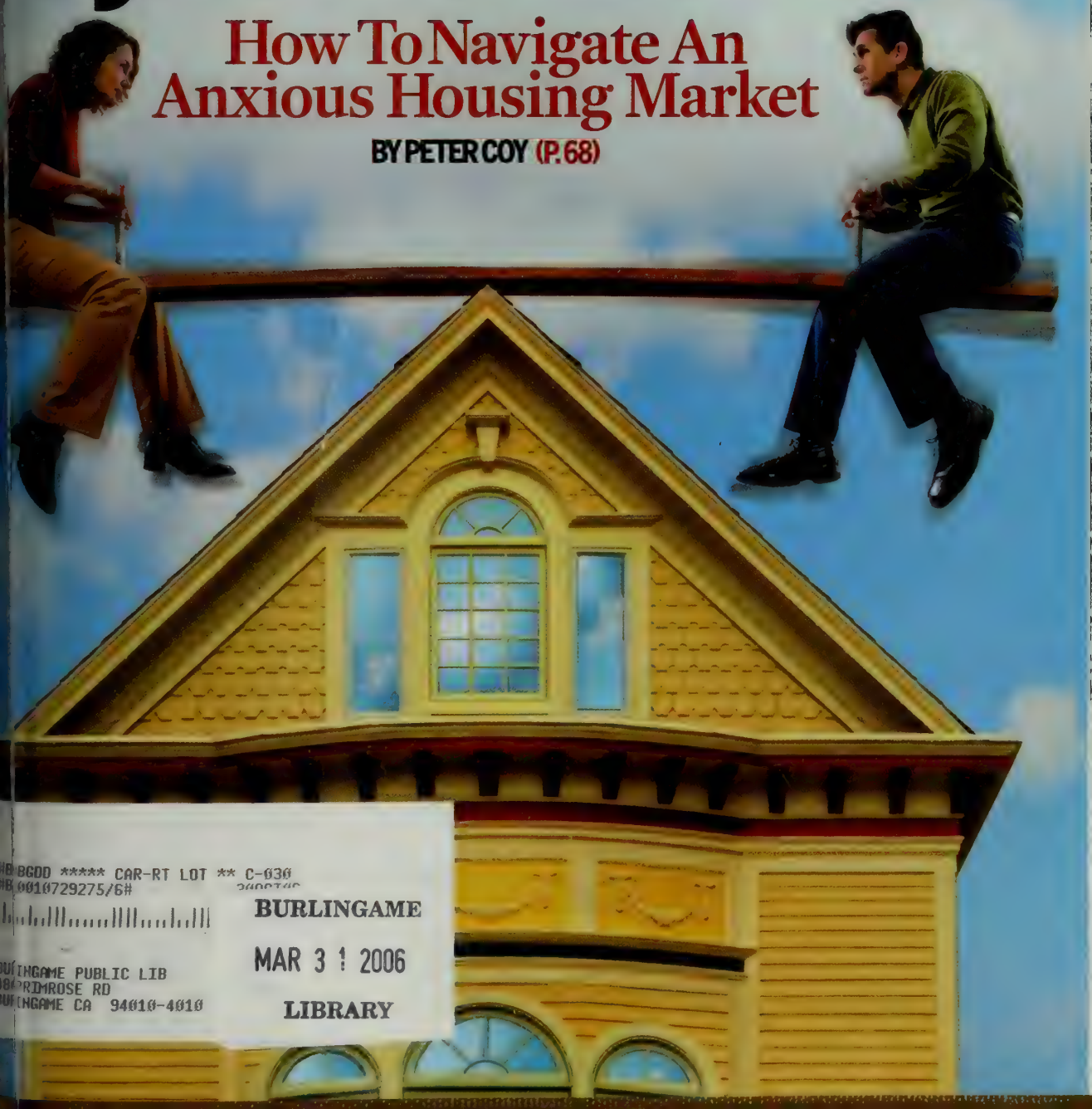
Buyer (and seller) Beware

How To Navigate An Anxious Housing Market

BY PETER COY (P.68)



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New York City 311

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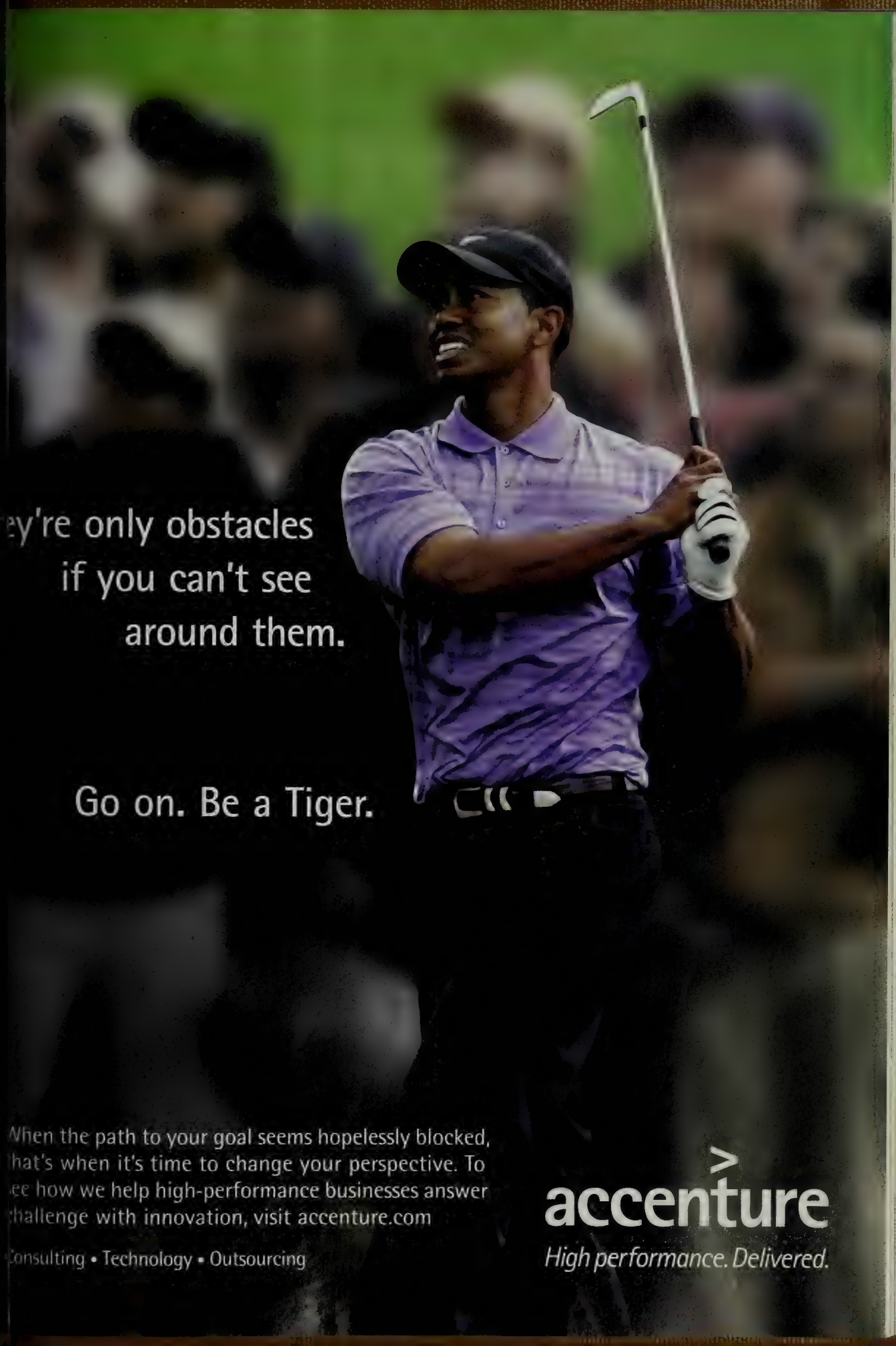
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BusinessWeek

April 10, 2006

68

MANY A SLIP

Behavioral economists have identified avoidable errors of judgment that lead to poor housing decisions

30

WHERE'S THE BEEF?

Burger King's IPO doesn't look so juicy

66

SOURCE FORCE

Marc Fleury stirs up open source

Cover Story

68 Buyer (and Seller) Bev

Confused about the direction of the housing market? You're in good company—in this clima everyone is running sca We can't predict which home prices will go ove the next year or so. But can tell you how to avoi some critical psycholog and financial mistakes

75 Real Estate Brokers Race for She

Why they're cutting commissions

76 Commentary: Housing Prices

Yes, a 10% drop is a real possibility

The Business Week

28 News You Need To Know

Immigration; home sales; a Fed ra hike; GM and Delphi; France; and

News: Analysis & Commentary

30 Burger King: The Taste Test

The chain's upcoming IPO may no appetizing as it looks

34 Corporate Cash: Use It Or Lose

Activists target those with big hoa

36 Keeping Up with the Googles

Microsoft pushes into online servi

37 The Sneakiest Computer Virus A

Cyberthieves are learning cleverer

38 Choctaws: Deep in the Big Mud

The tribe looks to clean up on Kat

39 Wal-Mart Goes Organic

And small farmers aren't happy ab

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. oil giant Rosneft has vast
ı. So why are investors wary?

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ıington Outlook
ation: Why business could get

nce

Secret Lives of Short-Sellers
of hedge funds and indie
raises new questions about
ıdowy world

ge Funds: Biotech Bane or Boon?
stepping in as VCs balk at
drug development

aging

k, Find Me an Idea Czar
on chiefs are the rage

Corporation

ecca for Mall Rats
ppers love Steve & Barry's

Workplace

UAW: On a Long Dirt Road
it struggles, the union faces the
hallenges of its existence

rmation nology

tation of Your Dreams
site YouTube grow up to be the
, or the next Napster?

64

EYEBALL CATCHERS
In a mere 11 months, YouTube has become a Web phenomenon, showing 30 million videos a day

People

66 The Bad Boy of Open Source
Marc Fleury's Oracle deal fell apart. Now JBoss may be headed for an IPO

Science & Technology

78 Developments to Watch
A nanotech brain wave; more feasible fusion; cleaning up heavy metals

Media

79 Book Publishing Rewrite
The days of the orderly hardcover-paper-audio-Web progression look numbered

Environment

80 New Juice for Alternative Energy
"Green certificates" are giving it a boost

82 Suddenly, HP is a Green Guru
Why it's pushing tough recycling laws

Personal Business/ Mutual Funds

88 The Best Managers
The 2005 S&P/*BusinessWeek* Excellence in Fund Management Awards

89 Janus Mid Cap's Value Brothers
Tom and Bob Perkins can spot bargains

94 Oppenheimer: Eye on the Small-Fry
Its Main Street fund juggles 1,200 stocks

94 First American's Real Estate Junkies
These managers know the lay of the land

96 Where Any Stock is Fair Game
James Stratton has been picking winners of all stripes since 1972

98 Your Digital Family Album
How to preserve those memories forever

99 Driving GM's Great Wide Hope
Behind the wheel of the GMC Yukon

100 Aquavit, in Some Far-Out Flavors
The Nordic liquor gets an update

102 Personal Business Plus

Columnists

20 Wildstrom: Technology & You
Must-haves for digital DJs

22 Fine: Media Centric
Kevin Slavin's company creates games where players hide-and-go-seek an ad

25 Cooper: Business Outlook
Up till now, predicting Fed policy has been easy. That era is over
Inventories: The cupboard is still too bare

104 Marcial: Inside Wall Street

112 Jack and Suzy Welch: The Welch Way
Paying CEOs big-time for failure

Ideas

110 Books
Uchitelle: *The Disposable American*

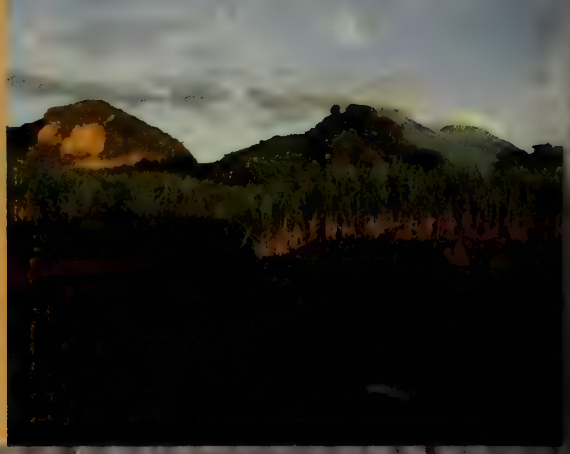
111 BusinessWeek Best-Seller List

114 Outside Shot: Tom Daschle
Why health reform is good business

Features

13 UpFront
18 Readers Report
19 Corrections & Clarifications
106 Figures of the Week
108 Index of Companies

> > >



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Say "aaah": Swedish performance car Koenigsegg CCX

Zooming into the Future

Our online special report, **Cutting Edge Cars,** features a collec of vehicles that push the limits of design, speed, and techn If you think Swedish autos are staid and serious, not fast a furious, read about the **Koenigsegg CCX,** a performance car t has been clocked at speeds of up to 245 mph. You're not lik to see one on the road or in a showroom, but you can virtua kick the tires in the accompanying slide show. No carmake be considered up-to-date without a big push into hybrid engines. Our report takes a look at French auto maker Peugeot's efforts to develop **super-efficient hybrids** using a diesel engine rather t gasoline-powered one. The company, which previewed the Peugeot 307 and Citroen4 at the recent Geneva Auto Show plans to have these 82-mpg cars for sale by 2010. If you re want to be on the cutting edge, how about a car that soars traffic jams? **Flying cars** have been a dream for 90 years, an slide show looks at some of the failed attempts, as well as current designs that may be on the market soon. For these features and more see our special report at **www.businessweek.com/go/cutting_edge_cars06**

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UP Front

"What you've got here is a quarterback with an out-of-date playbook."

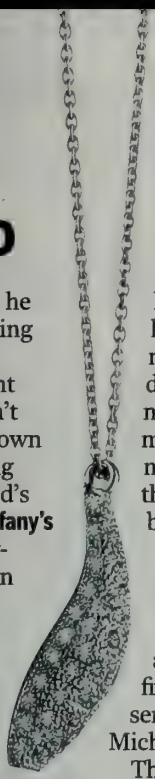
–Efficiency expert James P. Womack on General Motors CEO Rick Wagoner, who is under pressure to save the company and his job, as reported by The New York Times

) BY
AH STEAD

G

RY IS RL'S T FRIEND

GEHRY once said he eaked out by going oad and being ed like Yves Saint t," but that didn't nerica's best-known t from accepting he fashion world's clusive gigs. **Tiffany's** d its new Gehry-d jewelry line on with a Beverly owout worthy Paris runway -list attendees Vilson, Quincy nd Michael strolled the et. Behind a wall, wearing almost but Gehry's jewelry e glimpsed through cally placed les.



Gehry worked with nine Tiffany designers for three years on the collection, which ranges from $125 silver rings to a $1 million diamond brooch shaped like the floor plan of his landmark Guggenheim museum in Bilbao. To design the jewelry, Gehry made sketches and manipulated metal models, a process akin to the way he designs buildings.

Tiffany hasn't used an outside designer since it launched its Paloma Picasso line 26 years ago. "We just couldn't find anyone that made sense," explains CEO Michael Kowalski.

The line rolls out over the coming months at Tiffany stores in New York, Tokyo, and London. Expect Gehry to hit the road and help promote it.

–Christopher Palmeri

BIG PIC

AMERICANS WON'T DO? After farming) and custodial jobs (17%), construction U.S. sector with the biggest percentage) of illegal immigrants. Construction jobs he highest concentration include...

on	Illegals
tion workers	36%
f's	29
ll installers, g tile installers, pers	28

panic Center

MOST LIKELY TO SUCCEED Moskovitz and Zuckerberg

WHEELER DEALERS

Omigod, That Site is Totally Hot

FACEBOOK, the Web site where students around the world socialize and network, has been creating a fair share of gossip on its own these days. The company has been in informal talks with **Viacom** about possible deals that could have valued **Facebook** at up to $750 million. **Viacom,** owner of the **MTV, VH1,** and **Comedy Central** cable networks, declined to comment. CEO Mark Zuckerberg started Facebook in 2004 with Harvard classmates Chris Hughes and Dustin Moskovitz. The site is now the seventh most heavily trafficked on the Internet.

According to one investment banker active in technology deals, Facebook's owners would want $1 billion in a merger. A senior media executive puts the pricetag at $2 billion.

Those are controversial valuations. "Facebook won't get $2 billion or $750 million," argues Rafat Ali, editor of **PaidContent,** an online digital media journal. But **Netscape** founder Marc Andreessen says that he "wouldn't be surprised" by a big payday for Facebook's founders. After all, he says, the company is on a growth tear at a time when traditional media outlets are losing steam, and top-tier Net properties are in high demand and short supply.

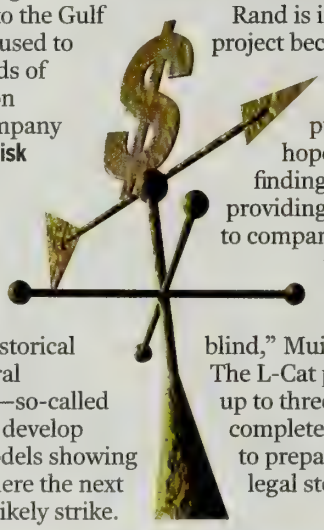
–Steve Rosenbush

UP Front

FORECASTS

IS THAT A LAWSUIT BLOWING IN?

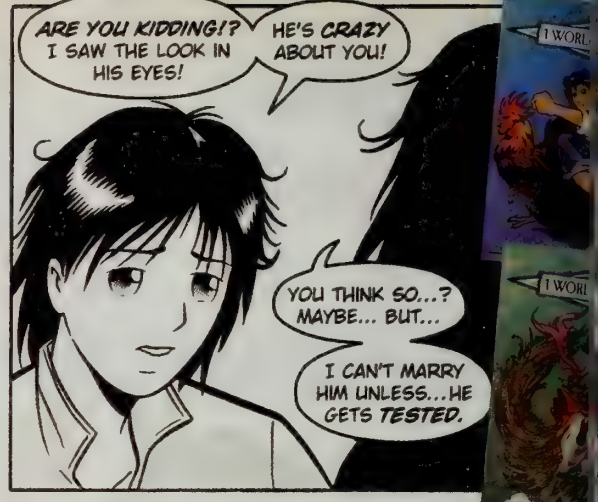
ARE CLASS ACTIONS like hurricanes? Researchers are looking into whether techniques used to predict the risk of a big storm slamming into the Gulf Coast can be used to assess the odds of mass litigation striking a company or industry. **Risk Management Solutions,** a private risk-modeling firm based in Newark, Calif., uses historical data on natural catastrophes—so-called Nat-Cats—to develop computer models showing when and where the next disaster will likely strike.



Now social scientists at think tank **Rand** are teaming with RMS to see if data drawn from court files and insurance records can help predict "L-Cats," or liability catastrophes. Robert Muir-Wood, chief research officer at RMS, defines an L-Cat as something that results in a financial exposure above $100 million.

Rand is interested in the project because big lawsuits tend to have an impact on public policy. RMS hopes to sell its findings to insurers providing liability coverage to companies. "In the past, these policies have been written fairly blind," Muir-Wood explains. The L-Cat project will take up to three years to complete—in time, maybe, to prepare for the next legal storm.

–Michael Orey



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JAPANESE COMICS meet the World Bank in *1 World Manga*, a graphic-novel series th bank commissioned to teach youth about global ills like poverty and AIDS. The novels, created by VIZ Media of San Francisco, fea Rei, a 15-year-old street kid. In the first of s planned books, he urges a woman to join a cooperative after a drought wipes out her crop. Despite dialogue like "That foreign company promises to give us fair trade payment," the comics entertain. Jeff Yang, analyzes Asian trends for consumer-resea firm Iconoculture, says they'll attract the m kids reading *manga* who increasingly see th selves as global citizens. *–Elizabeth W*

BLOGSPOTTING

NAME THAT TUNE

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» **WHY READ IT** For an overview of macroeconomic trends, leavened by the pop-culture musings of market strategist Barry Ritholtz.

» **NOTABLE POST** "Lately, I have been noticing that many economists, analysts, and strategists have been having some sly fun by naming their research after songs. My own contributions...have been the past two commentaries: Bad Moon Arising and Been Down So Long (It Looks Like Up to Me)...I also noticed [analyst] John Roque's past two comments were titled BRIC House and R-E-S-P-E-C-T. And Morgan Stanley asked: Will the Real Slim Saving Rate Please Stand Up?"

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Up Front

NOSH!

MIGHTY SALES FOR MINI SNACKS

Betting that snackaholics prefer fixed-portion control to self-restraint, the food industry is selling more of America's guilty pleasures in 100-calorie packs. Just a few weeks ago, PepsiCo's Frito-Lay announced its 100-calorie line—Mini Bites bags of Doritos, Fritos, and other chips to be rolled out nationally over the next year. It joins, among others, Campbell Soup's Pepperidge Farm, which offers 100-calorie pouches of its Goldfish, and Kraft Foods' Nabisco, which in 2004 brought out 100-calorie packs of Oreo crisps, Wheat Thins, and Chips Ahoy! cookies, a lineup with $100 million in sales in its first year.

Frito-Lay's entries bring the number of 100-calorie snack products to 33, up from 9 in 2003, says Tom Vierhile, director of Datamonitor's Productscan Online. Why 100 calories? "It's a nice round number" that delivers "the calorie punch" needed to give a sensation of being full, Vierhile says. If it doesn't, you can always tear open another pack. *–Jessi Hempel*

CAPITOL HILL

FASHION'S BID TO KNOCK OUT KNOCKOFFS

MASS MARKET retailers have always carried inexpensive versions of the designer fashions their customers have glimpsed on the red carpet or the runway. That's because clothing is considered a "useful article" under American copyright law, not something whose design is to be protected as intellectual property.

But that distinction may be on its way out. The Council of Fashion Designers of America (CFDA), a nonprofit trade group, is lobbying for legislation that would extend copyright protection to fashion designs. Under the proposed bill, designers would submit sketches and photos to the U.S. Copyright Office within three months of their design's "publication"—its first public appearance on a catwalk, for example. Designs would be protected for three years. Suspected "plagiarists" could be sued.

Other industrialized countries, such as Japan and European Union members, already recognize fashion copyright. (France's legal system has protected garment designs since 1793.) "This law will make it reciprocal, by giving all designers protection over their work in this country," says Alain Coblence, the attorney representing both the CFDA and two other sponsors of the bill, the **French Federation of Haute Couture, Ready to Wear & Designers** and the **National Chamber for Italian Fashion.**

To make its case on t Hill, the CFDA hired **Li Robbins,** a lobbyist wh taken on intellectual p issues for the music in And CFDA members su couture designer **Zac P** have visited members Congress to talk up the Coblence says that wh designers have shown lawmakers their fashio alongside the knockoff "it becomes spectacula clear" why these imita are a form of flattery th live without.

–Elizabeth

SCREEN TESTS

SILICON Valley hot shots are becoming Hollywood big shots. A few Web moguls and the recent film releases they've backed:

JEFF SKOLL (former president, eBay)

FILM: *Syriana*. A politically charged thriller about intrigue in the global oil industry. One of about a dozen films financed by Skoll. Budget: $50 million.

MAX LEVCHIN (above) PETER THIEL, AND ELON MUSK (co-founders, PayPal)

FILM: *Thank You for Smoking*. A satire that follows a fictional Big Tobacco lobbyist as he makes his rounds. Budget: $7 million.

SERGEY BRIN (le AND LARRY PAG (co-founders, Goog

FILM: *Broken Arro* The story of a man who turns professional killer after his pregnant dies in a terrorist attack. In producti Est. budget: $1 mil

Data: *BusinessW*

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"Boomers are going to follow their emotions with their pocketbooks. Where can I buy the stock?"

–Stephen D. Carter
Snellville, Ga.

A SLEW OF ANGLES ON ANTI-AGING

"SELLING THE PROMISE of youth" (Cover Story, Mar. 20) ignored the important achievements in anti-aging of the U.S. biogerontological community in recent decades. Several prominent biogerontologists believe that if adequate funding were available, human longevity could be extended anywhere from 10 to 20 years of vibrant life, free of aging-related diseases like cancer and cardiac illnesses, in the next 10 years.

However, the National Institute on Aging is starving for money for longevity research. Its total budget is about $1 billion, but longevity research receives only $20 million to $50 million—most of the money goes to aging-related diseases. The principal reason is that Congress worries about the impact of extended human longevity on Social Security. Yet according to the March, 2005, report by the Trustees of Social Security & Medicare, the cost of Medicare will reach 6% of gross domestic product in 2024, exceeding that of Social Security. In 2025 it will amount to $1.3 trillion and in 2080, $14.75 trillion (in 2004 dollars)—more than twice as high as the cost of Social Security. Extending human longevity aging-related diseases, could signi cut the cost of Medicare, though i increase the cost of Social Securit

–Victor
Vie

BOOMERS ARE GOING to follo emotions with their pocketbooks. can I buy the stock?

–Stephen D
Snellv

PHARMACY COMPOUNDING physicians to prescribe individ treatments, including bioidentic mones, to meet their patients' needs—needs that are unmet by factured, one-size-fits-all product boards of pharmacy regulate the p tion of bioidentical hormones, a ingredients are regulated natio 2002 the U.S. Supreme Court up First Amendment right of compo pharmacists to market their prep or medications. Still, pharmaceu ants like Wyeth falsely argue—an like this one misleadingly report— growth in the number of physici their female patients choosing bi

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mones over manufactured ones is ce of illegal mass marketing.
s of Wyeth's hormone products are significantly since a study linked o increased risk of heart attack and And while women and their ans appear to be searching for op- Vyeth is lobbying the Food & Drug istration to protect its pocketbook. is not the first time Wyeth has o. About 10 years ago the company sfully lobbied to keep a generic of Premarin off the market. It be a shame if Wyeth got away with ain.

–L.D. King
Executive Director
International Academy of Compounding Pharmacists
Sugar Land, Tex.

ERE IS NO "scientific proof that egimens actually slow down or re- e aging process," I can only think ese are simply placebo pills for the who take them.

–Alexandra Martin
San Diego

ARLY DAYS OF PHONE SERVICE E DO-IT-YOURSELF WEB

HY THE WEB is hitting a wall" (In- ion Technology, Mar. 20): Imagine would have happened when tele- service was evolving if consumers choose from a dizzying array of op- uy and install their own expensive ent, fix it themselves if it broke, orry about their conversations be- nitored by criminals. I suspect that percentage of households would oted not to have phone service. No r the Web is hitting a wall.

–James J. Higgins
Manhattan, Kan.

O HIRE THE CANDIDATES LIKELY TO SUCCEED

MOVIE MOGUL" (Voices of Inno- Mar. 20) illustrated a disturbing despread problem with corporate practices: Mika Salmi possesses drive, ambition, persistence, and lity to recognize opportunity. Yet mpanies rejected him outright. y companies today use software to résumés based on keywords and ostly on human resources clerks tle or no true business experience to selected résumés. How can they ize the traits shown by Mika and like him? Steve Jobs, Bill Gates, and uban would have been rejected by artments at many companies. Career ads for these companies need to carry the disclaimer: "Achievers and mavericks need not apply."

–George Muenz
Vancouver, B.C.

CORRECTIONS & CLARIFICATIONS

In "The BusinessWeek 50" (Cover Story, Apr. 3), No. 49 Hartford Financial Services Group Inc. is based in Connecticut, not Maryland.

"The whole truth about options" (Up Front, Apr. 3) misstated that Bank of America Corp. listed dollar values for executive stock options for the first time in its 2006 annual proxy. While dollar estimates were newly listed as part of "total compensation" this year, they appear elsewhere in previous company proxies.

"Background checks that never end" (News: Analysis & Commentary, Mar. 20) should have said that John Sculley was ex-president and CEO of Pepsi-Cola Co., not parent PepsiCo Inc.

"Rewiring Chuck Prince" (Finance, Feb. 20) should have specified that Citigroup continues to do shipping finance but that it no longer has a separate shipping finance division. Also, in response to a question at a conference about whether Prince would consider dilutive transactions, he said: "The word never is a big word...but in the practicalities of what all of us have to deal with, the chances of that happening are virtually nil."

PRICING HANDMADE RUGS IS MORE COMPLICATED THAN IT SEEMS

HANDMADE RUGS ARE continuously portrayed as unworthy of a fair profit margin for the companies that make them ("My magic carpet ride in India," Personal Business, Mar. 20). As a retailer, appraiser, and wholesaler, I have never seen a consumer come back from a source country having purchased a carpet at a "fair price" or even one that was mildly attractive—just an expensive souvenir complete with a story sometimes so ridiculous the teller only realizes it when he or she steps off the plane and repeats it.

Obeetee, the largest producer and seller of Indian carpets in the world, has produced rugs for the U.S. market for nearly 60 years, supplying many of the national brands U.S. consumers readily associate with quality, value, and taste. Your story insinuates that Obeetee pays commissions to hotels for referrals and that our carpets are dramatically overpriced—neither is true. "Rug rules...and resources," the rudimentary summation of how to buy a carpet, lacks substance and cites an "insider's guide" that is nearly 30 years old.

Please, no more articles on handmade carpets unless you intend to evaluate the content, source, and references with the same standards you would any other industry. We work in a vibrant business with creative, hardworking people making products that can last for more than 100 years. It is a shame that outdated and misleading perceptions can last just as long.

–Bill Ward, CEO
Obeetee Inc.
New York

PAY FOR PERFORMANCE HAS LONG SINCE BEEN POOH-POOHED

RE JENA McGregor's review of *Hard Facts, Dangerous Half-Truths & Total Nonsense*, by Jeffrey Pfeffer and Robert I. Sutton ("Forget going with your gut," Books, Mar. 20): Who would have thought pay for performance might be flawed—O.K., besides W. Edwards Deming and Peter Scholtes, who have been saying it for decades?

Those of you who swear by pay for performance, please find a controlled study (a.k.a., facts) that supports your position. If pay for performance works and you'd like to improve your workers' performance, why not give them all a 10% raise?

–Preston Black
Cincinnati

DOES THE U.S. SENATE VALUE DECORUM ABOVE ALL ELSE?

THE OBSERVANCE OF the U.S. Senate's ancient rules of decorum apparently is more fitting than accomplishing its work ("Spittoons and quills but no laptops, please," Washington Outlook, Mar. 13).

–Russell R. Griffin
Saint Cloud, Fla.

How to reach *BusinessWeek*

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Technology&You

BY STEPHEN H. WILDSTROM

Must-Haves for Digital DJs

Like many folks who have plunged into digital music, I have a large collection—nearly 30 gigabytes—stored on a hard drive, and I treasure t freedom to dip into it wherever I choose. So I was eager to try two new products, the Roku SoundBridge Radio and the Apple iPod Hi-Fi, that c relatively inexpensive ways to enjoy digital music with high-quality sou

The $400 SoundBridge Radio looks a bit like an oversize version of those big clock radios you find in hotel rooms. And like them, it can play music to put you to sleep as well as to wake you up. But in addition to AM and FM broadcasts, a SoundBridge connected to a Wi-Fi wireless network plays Internet radio stations—Web sites that stream programming—as well as any music stored on a Windows PC or a Mac on the network.

The beauty of the SoundBridge is that it looks and feels a lot like a radio, even when it's playing tunes from your own collection. Nearly 100 Internet stations are preloaded, and they can be selected either by presets or by scrolling through a list on the big, bright display. The SoundBridge also searches your network for iTunes or other music collections, such as Musicmatch or Rhapsody. Choose a collection, then select the song, artist, album, or playlist that you want to hear, using either a remote or buttons on the SoundBridge. Getting this to work the first time may require changing some security settings, for which Roku provides clear instructions. The SoundBridge will play purchased or subscription music protected by Microsoft's PlaysForSure but not songs bought from the iTunes Music Store because Apple doesn't allow use of its copy-protection technology.

iCANDY Apple's own Hi-Fi (above) and the Roku Sound-Bridge Radio

ROKU KEPT THE SOUNDBRIDGE SIMPLE by having you use a computer to do any complicated administration, especially anything that involves entering data. For example, you add more Internet stations by typing in their addresses on a Web page you can access from a computer on your network. But in one important respect, the SoundBridge is too simple. It supports only Wi-Fi's outdated Wired Equivalent Privacy security scheme, not the much stronger Wi-Fi Protected Access, and this requires you to use weak security on your entire network. Roku promises to fix the flaw.

Of course, none of this means much the player provides solid audio, and the SoundBridge delivers. Its two speakers subwoofer are a good size. It's true that volume won't rattle your windows, and the best stereo effect, one might wish tc separate the speakers by more than the width of the radio. Still, the sound is ju for a bedroom, study, or cozy kitchen.

Apple has also moved up to true higl fidelity, exhibiting its usual flair. The iPo brought simplicity to music, and products d come any simpler than $349 iPod Hi-Fi. It's a box, 17 in. wide and al in. tall and deep. It ha buttons, not even a po switch. Plug it in and iPod made in the last of years (except the Sl into a slot on the top.

Playing music thro the Hi-Fi's speakers is just like listening to an iPod thro earphones. A tiny remote is included—the same one us with Apple's new Macs—but all it does is control volum let you move to the next or previous song in your playli (Sorry, no way to access the full menu from your couch. Hi-Fi has the best sound quality of any iPod speaker un including the popular $300 Bose SoundDock. In fact, o ironic drawback is that the Hi-Fi will show up flaws in music that you would miss with cheap ear buds.

These products share a refreshing simplicity. Like go consumer appliances, they don't try to do too much, an things they focus on they do well, with a minimum of fi only the PC industry would take this approach to heart.

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Hide-and-Go-Seek an Ad

The ad world is filled with slick, ultrastylish characters. Kevin Slavin is n one of them. Today, Slavin, the managing director of a company called area/code, is wearing a rumpled button-down shirt and battered brown sneaker-shoes. His glasses are strictly functional. His hair is not artfully mussed. He sits in a featureless conference room in Manhattan, strainin

to be heard over truly violent-sounding construction on the street below. When the 36-year-old self-described "game freak" says he disconnected his DirectTV because "it was cutting into my Xbox time," you believe him.

Slavin's endless enthusiasm for games encompasses even chestnuts such as capture-the-flag, and somehow he has managed to extrapolate a business from this obsession. Area/code, which Slavin co-founded with veteran game designer Frank Lantz, creates complex, ad-sponsored, multiplayer games that use a city's physical landscape as a playing board—"urban games" or "big games" in gamer parlance. Lance and Slavin thus outline scenarios in which advertising is not just tolerated but welcomed.

APRIL, 2004 Pac Manhattan players in Greenwich Village

TODAY'S BIG GAMES go beyond Civil War reenactments. Players can be joined through the connective tissue of cell phones and Wi-Fi, which provide instant communication among players dispersed across large geographic areas and allow a game to be tracked in real time on the Web. This was the technological fairy dust sprinkled over Lantz' Pac Manhattan, in which a re-enactment of the '80s video game classic was played out over several square city blocks in 2004. Popular games cast long shadows, and Pac Man remains a prominent cultural touchstone, which is one reason why Pac Manhattan won so much notice. The attention caused a light bulb to go on for Slavin, then working at an ad agency. "I was thinking," he recalls, "this is media. This is a form of media we don't yet know how to articulate." The new form can crank up the kilowattage of marketing efforts, he says, by providing "actual experiences for people instead of telling them about something" and making those experiences public and visible to others. (This inverts the standard ad model, that aims at individuals and often celebrates private sensations: Our product will make you feel this w

Lantz and Slavin later collabo on ConQwest for Qwest Commu cations cell phones, which in 200 2005 unleashed teams across 10 in search of a coded image to be photographed with camera phon That image appeared randomly i those cityscapes and when photographed yielded clues and riddles. It also appeared in week papers and fake ads in public sp (The mock ads were top-drawer, deadpan parodies with taglines "it smells so good you'll fall in lo with yourself.") ConQwest cost $3.2 million, yet the novel camp a second-tier cellular player had effect similar to Pac Manhattan's mentions were many and glowi industry awards followed.

Area/code's vision borrows from others. It partly ech dodgeball.com, a real-time mobile social networking sy in which users trade their whereabouts while out and about. It also recalls the short-lived "flash mob" trendle which groups of strangers quickly gathered, performed predetermined activity, and dispersed from random urb meeting grounds. Like a skateboarder, area/code sees u possibilities for play in a city's street-level architecture.

It helps that area/code is more game-centric than marketing-centric. "They invest in an experience in its right, which happens to communicate" a marketing message, says Matt Jones, senior design manager for u experience at client Nokia. That experience is both nex generation and traditional, by tapping into half-forgot moments of childhood spent wholly caught up in the f a game. If advertising seeks to make us all hungry chil at least area/code gives us a playground and throws th doors open for recess. ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

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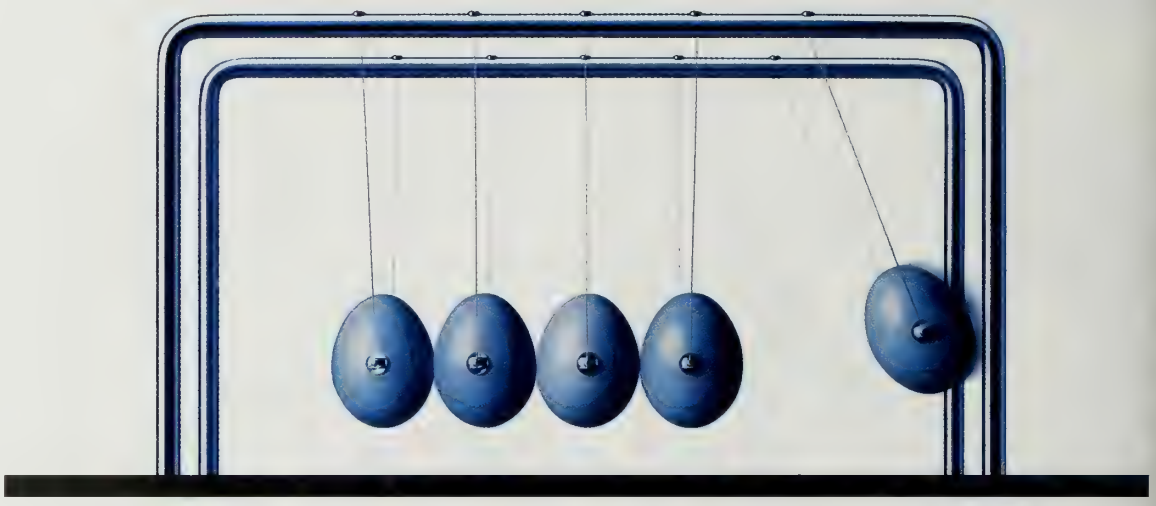

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MES C. COOPER

rom Here On Out, he Fed Is Winging It

uncertainty over future rate decisions will mean bumpier markets

.S. ECONOMY The Federal Reserve's first policy decision under chairman Ben S. Bernanke was, as expected, a no-brainer. The ifted its target interest rate on Mar. 28 by a quarter-point for the time in the past 15 meetings, to 4.75%. The post-meeting ment included a bit more detail on economic activity, but the key

lated remarks were carbon copies of the Jan. 31 In all, it was an obvious display of the greater ency and continuity that Bernanke has promised. t gets interesting—for both the markets and akers. Up to this point, judging Fed policy has y. Back in June, 2004, the Fed essentially told the it was going to lift its target rate from a 46-year % that was highly stimulative to economic growth e neutral level historically consistent with healthy and low inflation. Until now, the patterns in the c data played only a small role in the Fed's game at phase is over.

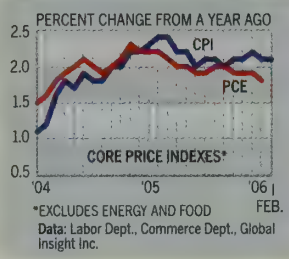
is no more road map for the markets to follow. akers' Job 1 is to decide whether the current te of 4.75% is high enough to assure that will stay under control in the coming year. Not he markets not know what the Fed's next move he Fed itself doesn't know. That means much certainty surrounding future Fed actions, and certainty means greater volatility.

t reaction immediately following the Fed's hike is a case in point. Stock and bond prices r disappointment that the Fed did not hint that of its tightening cycle was near. On the contrary: repeated its Jan. 31 language, saying that "some olicy firming may be needed." The Dow Jones l average suffered a 110-point turnaround after , and 10-year Treasury yields, which had begun t 4.71%, finished at a 22-month high of 4.78%. s like that appear to be in store as the Fed s way toward the right policy.

LL THE FED KNOW when its work is done? The that decision now shifts almost exclusively to the c data. The next action or inaction will depend he policymakers interpret what each new in the charts means for the trends in economic nd inflation. The upshot: Each economic report on increased significance for the markets, y for bonds, over the balance of the year. Data , particularly any that suggest stronger growth e inflation, may pack more of a punch than they o now.

What signposts will the Fed be looking at? Of course, policymakers will say they consider everything. But three broad classes of data will probably command the Fed's attention. Readings on core inflation, which exclude energy and food, will show whether higher energy costs are working their way into the prices of other items. Labor-market data will indicate whether wage and salary increases are outstripping productivity gains. And housing activity will be a key bellwether, given its past importance to overall growth and consumer spending.

ALL QUIET ON THE INFLATION FRONT



Data: Labor Dept., Commerce Dept., Global Insight Inc.

Right now all three are sending fairly positive signals to the markets, suggesting the Fed might need only one more hike, to 5%, at its May 10 meeting. Policymakers undoubtedly take great comfort in how the price indexes are behaving. Despite the two-year runup in energy prices, current core inflation readings at the consumer level show not the slightest hint that costlier energy is pushing up other prices. The core consumer price index (CPI) in February stood only 2.1% ahead of its year-ago level, and the Fed's preferred inflation gauge, the core index for personal consumption expenditures (PCE), is slightly below 2% and has been edging lower (chart).

In coming months, any higher-than-expected readings in the price indexes hold the greatest potential to rattle the markets, for two reasons. One, they would suggest that the Fed is lagging in its efforts to control inflation. And two, current inflation rates tend to influence people's expectations of future inflation, which can feed back into pricing behavior and become a vicious cycle.

BUT EVEN IF THE PRICE INDEXES remain tame, the Fed will also keep a keen eye on the strength of the economy. Labor markets are stretched thin, and the ability of industrial and service companies to meet

demand is being tested. If the economy does not give convincing signs of cooling off in a way that will relieve these pressures, the Fed may feel the need to push its target rate north of 5%.

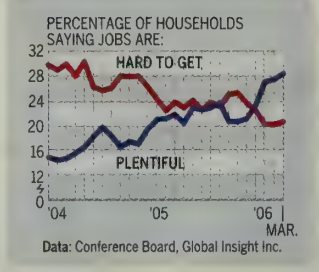
Perhaps the most difficult task for the Fed this year will be correctly interpreting the interplay between improving labor markets and slower housing. Both will influence consumer spending, but in opposite ways. The view in the markets right now is that the housing slowdown will dampen consumer spending, as outlays for home-related goods wane and consumers stop using the equity in their homes as a source of income for spending.

The housing downdraft is clearly under way (page 68). In February sales of new homes were down 21% from their peak last July, while sales of existing homes are off 5% from their high point last June. Further weakness seems likely. The new-home and condominium markets, where activity has been especially frothy with high turnover, could take the biggest hits in terms of both building activity and prices. Inventories of unsold new homes in relation to recent sales rates have jumped to the highest level in ten years, suggesting a growing imbalance between supply and demand.

THE KEY QUESTION for future Fed decisions is this: How much will housing slow consumer spending? The answer will depend mainly on the health of the labor markets. The combination of improving income growth and past wealth gains, less than a third of which came from net home values last year, will help to offset housing-related losses to spending power.

So far, businesses remain optimistic about both c spending and hiring, and consumers are upbeat ab the economy and job prospects (chart). The Confere Board's consumer confidence index in March rebou from its February decline to the highest level in nea four years. Househ reported feeling be about both present future conditions, a their assessment of current state of the markets was positiv Although the perce of households desc jobs as "hard to get edged up from Feb 4½-year low, the proportion saying j were "plentiful" ro the highest level since August, 2001.

STRONGER JOB MARKETS ARE LIFTING CONFIDENCE



Data: Conference Board, Global Insight Inc.

All this leaves the Fed with a tricky balancing act stronger the economy, the greater the need for rates rise to assure that inflation stays down. But housing keenly sensitive to interest rates, so overtightening severely damage that crucial sector and possibly th overall economy. For the rest of the year, as policym sift through the data for clues on what to do next, investors would do well to prepare themselves for r bumpy days ahead. ■

INVENTORIES

The Cupboard Is Still Too Bare

AS DEMAND FOR manufactured goods has picked up, producers have yet to adjust their inventories accordingly. As a result, the decline in the inventory-to-sales ratio, a measure of the adequacy of stock levels, has accelerated in recent months. The trend is a favorable sign for increased factory activity.

In January overall business inventories were up just 4% from a year ago, the slowest pace in 19 months and far less than the 8.5% rise in shipments during the same period. February inventory levels of durable goods fell by 0.5%. This is a small part of business inventories, accounting for about 22% of the total, but it is an early indication that February inventory growth may be continuing to slow.

STOCKPILES LOOK VERY LEAN

Data: Global Insight Inc.

The ratio of business inventories to sales is down to a historically low 1.24 months' supply. It is true that this ratio has been drifting lower for years as businesses have taken advantage of better technology to streamline production and supply chains. But since June, 2005, the ratio has been falling faster than the average rate of decline since 2000.

The inventory data are useful because they're "giving you a signal about whether demand is higher or lower than expected," says Goldman Sachs economist Andrew Tilton. The recent rundown in the ratio may be a sign that demand is stronger than manufacturers expected. Indeed, the yearly percentage change in the inven to-sales ratio is a good leading indicator for the Institute for S Management's factory activity notes Tilton.

Economists see the ISM's M activity index rising further. Pl February factory survey showe respondents continue to believ customer inventory levels rema low. The ISM's index tracking inventory levels also show that manufacturers have let invento decline during the past 11 mon

Manufacturers may also feel need to bump up production t inventories to more comfortab levels. While businesses are str to keep supply chains lean, the limit. If inventories become to skimpy, businesses could face production disruptions—or ev possibility of lost sales. ■

–By James Mehring in N

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The Business Week

News you need to know

EDITED BY HARRY MAURER

A Fracas over Immigration Seemingly overnight, the immigration debate has grabbed the center of the political stage, spotlighting a rift in the GOP that could prove perilous come November. **Senate Majority Leader Bill Frist** (R-Tenn.) hopes to win approval by Apr. 7 of legislation that would make it a felony to hire undocumented aliens. But the **Senate Judiciary Committee** on Mar. 27 endorsed a business-backed approach that would beef up border enforcement and create a guest-worker program while letting illegals already in the U.S. pay a fine and earn eventual citizenship.

Pulling against each other are two pillars of the governing coalition: Socially conservative blue-collar workers, the GOP's most dependable source of votes, and Big Business. Some strategists fear that the surprisingly large demonstrations across the country (Boston, above) herald an anti-Republican backlash among Hispanic voters.

See "Immigration reform: Why business could get burned," page 41

The Housing Puzzle Home-sale numbers have real estate mavens scratching their heads. On Mar. 23 the **National Association of Realtors** said sales of pre-owned homes jumped 5.2% in February over the previous month, with the median price up 10.6% over the year before. Not too shabby. Well, on Mar. 24 the **Commerce Dept.** said new-home sales collapsed by 10.5%, with inventories higher than they've been in 10 years. At least one economist, *BusinessWeek*'s own **Michael Mandel,** has joined those expecting a painful bust.

See "Buyer (and seller) beware," page 68

Thunder from the Fed **Ben Bernanke** discovere found power when he drove the Dow down near points on Mar. 28—through no fault of his ow watchers were braced for the central bank's deci raise its benchmark rate by a quarter-point, to 4.75 investors took it hard when Bernanke & Co. failed to more strongly that hikes had come to an end. The F the impression that another boost in May is a sure t

See "From here on out, the Fed is winging it," p and "Interest rates: What the markets m www.businessweek.com/

Suspense in Detroit The **GM-Delphi-UAW** dra proached a showdown. Union reps turned up their n the latest offer from the bankrupt auto-parts maker, could void its labor contracts on Mar. 31, possibly set a strike in the next month or two that would clobber c Mar. 28 the carmaker laid off several hundred white staffers and filed its annual report with the **SEC,** stati accounting errors would force it to rejigger results fc nancing arm, **GMAC.** It also said other complications prevent it from selling GMAC for much-needed billio

See "Twilight for the UAW," p

To the Barricades! France's center-right governi scrambling for a compromise after weeks of sometim lent protest against a labor law that would make it e hire and fire young people. One option: **President J Chirac** could delay the reforms, which would spare **Minister Dominique de Villepin** loss of face.

Blue Bertelsmann For a company with a long his the music biz, Bertelsmann's timing sure seems off. C 26, the *Financial Times* reported that the company w offload its music business, a 50% stake in **Sony BMG Entertainment.** That would mean selling at the bottom market—and just when digital music is starting to pl crative tune. A spokesman calls news of a sale "sp tion," but privately held Bertelsmann may need the e ed $2 billion in proceeds to help buy out its largest investor and fend off an unwanted IPO of its stake.

A Telecom Tie-Up? **Lucent** excels in wireless gear. F **Alcatel** shines in broadband and fiber optics. Sound good match—at least they think so. Alcatel's board wa to discuss on Mar. 30 a $33 billion merger that woul the world's No. 2 telecom-equipment maker and give more clout in the U.S. One little problem: Lucent's B does some secret military work. The unit could be spu placed behind a Chinese wall.

See "Lucent-Alcatel: A marriage of e www.businessweek.com/

S&P Anoints Google Finally, a hint of sprin Google's bleak winter. Between Jan. 11 and Mar. search behemoth's stock sagged 28%. But the ne **Standard & Poor's** said it would add Google to its infl

0-stock index as of Mar. 31. (S&P is owned by *Busi-k* publisher **The McGraw-Hill Companies.**) By market n Mar. 29, shares had jumped 16%, to $395.

ing's White Knight Germany's **Bayer** thinks it ure for the migraine caused by bitter competition disastrous recall of its cholesterol-busting **Baycol** in n Mar. 24 the pharma and chemicals conglomerate $19.6 billion for Berlin-based Schering, trumping a bid from German compatriot **Merck.** Schering, nakes drugs for birth control, cancer, and multiple s, will give Bayer's pharmaceutical biz more heft.

See "A pick-me-up for German pharma," www.businessweek.com/go/tbw

ring Patent Power Patent trolls get little sympa-cept from the **Supreme Court.** On Mar. 29 the jus-t what seemed to be a friendly ear to **MercExchange,** f rights to technology behind **eBay's** popular "buy button. The case gets to the heart of debate over d trolls—companies that obtain patents only to hem. **Justice Antonin Scalia** pointed out to eBay that is allowed to take property from someone who want to part with it—even for a price.

See "EBay takes on the patent trolls," www.businessweek.com/go/tbw

.K. After months of delay, **Whirlpool** won permission 29 from the **Justice Dept.** to take over **Maytag,** its small-y-losing rival in white goods. Legal beagles had spec-at the $1.7 billion merger could be nixed since it ement Whirlpool's No. 1 spot. But Washington said ol is facing new competition from Asian outfits.

Exit of the Week

nakeup of sorts: With his poll numbers at record **resident George W. Bush** began to shuffle the White deck on Mar. 28 by replacing **Chief of Staff Andrew th Joshua Bolten,** head of the **White House Office of ment & Budget.** The move won't placate Republi-aying for new blood at , since Bolten, 51, is a e Bush adviser. Before the Bush team, he was **n Sachs'** executive direc-legal and government in London. Card, 58, is econd longest-serving f Staff in history, but his ement skills came into n after the botched response to **Hurricane Katrina,** advised Supreme Court nomination of **Harriet** nd the snake-bit **Dubai Ports** deal. While Bush de-nors of a staff purge, senior Administration offi-y Bolten will make any further changes he necessary. His OMB deputy, **Joel Kaplan,** appears e front-runner to become budget boss.

JOSHUA BOLTEN

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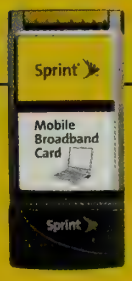

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IPO WATCH

WHERE'S THE BEEF?

Burger King's upcoming IPO looks lucrative...for the private-equity firms doing the deal. While they make even more cash, the chain's long-term debt could hit $1 billion. BY DEAN FOUST

ON A SUNNY SEPTEMBER day in 2004, Burger King Corp.'s new CEO, Gregory D. Brenneman, drove into the parking lot of the company's Miami headquarters dressed up as the fast-food chain's well-known mascot, the King. After a pep rally to congratulate the 700 assembled employees for their role in Burger King's nascent turnaround, Brenneman and other execs handed out burlap bags stamped with big dollar signs. The sacks were stuffed with bonus checks. And they were three times larger than the previous year's. It was a gesture that endeared the new boss to his troops.

Now Brenneman is trying to win over a much tougher crowd: Wall Street investors. Sometime this spring, Burger King's owners, a group of private-equity firms that includes Texas Pacific Group, Bain Capital Partners, and Goldman Sachs Funds, plan to raise up to $600 million in an initial public offering. Assuming the IPO is successful, the private-equity guys will have nearly doubled their original investment—while retaining a majority stake in Burger King. Not bad for about three years' work.

The coming Burger King IPO offers a window onto the clubby world of cash-rich private-equity players and how they make their billions. During the 1980s, firms such Kohlberg Kravis Roberts & Co. and Blackstone Group LP borrowed heavily to buy companies, broke them up, and sold off the pieces at huge profits.

"LIPSTICK ON A PIG"

NOWADAYS PRIVATE-EQUITY firms often spend hundreds of millions of their own money on an acquisition (BW—Feb. 27). Just as often, though, they load up the companies with debt and use the money to pay themselves special dividends and other fees that allow them to profit even if the company itself struggles. Then the backers take the company public, often pocketing the lion's share of the offering.

That is basically how the Burger King saga is unfolding. For investors hoping to get in on the IPO, the question is whether the burger

MARK LUND

IN THIS SECTION:

Companies swimming in cash are targets **37** The sneakiest computer virus around **38** A fat Katrina contract for the Choctaw tribe? **39** Wal-Mart: Guess who's going organic

The average BK location generates half the revenue of a McDonald's

chain is really on the road to recovery. Critics argue that since an initial rebound in traffic after private-equity players bought the company from Diageo PLC, Burger King's sales growth again is starting to lag rivals.

And they contend that the company paints an overly rosy picture in press releases and its recent Securities & Exchange Commission filing, in part by changing the way sales are tracked to give the appearance that they are on a solid upswing. What's more, Burger King is far more indebted than rivals McDonald's Corp. and Wendy's International Inc. That limits the fast-food chain's ability to reinvest in new products and restaurants. "This is as close to putting lipstick on a pig as you get," says a prominent Wall Street analyst who asked not to be identified.

Both Burger King and Texas Pacific declined comment on these and other matters, citing the restrictions against companies talking during the "quiet period" imposed by the SEC before IPOs. But some analysts and investors believe Texas Pacific and its partners are rushing Burger King to market before it's ready.

It's no secret why they want to get this deal done. Recent restaurant IPOs such as Chipotle Mexican Grill Inc. and Wendy's spinoff of the Tim Hortons Inc. doughnut chain were scorchers. And if there's any firm that knows when and how to buy and sell companies, it's Texas Pacific. Founder David Bonderman, a former bankruptcy attorney, made his name managing the oil wealth of Fort Worth's well-known Bass family. In the 1990s, Texas Pacific scored big with investments in Continental Airlines, Seagate Technology, and Oxford Health Plans. The firm was so successful that when Bonderman turned 60, in 2002, he hired the Rolling Stones to perform at a private bash in Las Vegas.

By all accounts, Bonderman and his investing partners got a great deal for Burger King in 2003. Diageo originally sought $2.26 billion for the burger chain, but Bonderman and his LBO partners succeeded in knocking the price down to $1.5 billion. What's more, analysts believe Texas Pacific, Bain, and Goldman kicked in just $325 million of their own money, opting to borrow the rest.

Then this past February, Burger borrowed an additional $350 mill its owners could pay themselves a two partners a special $367 millio dend. In addition, Texas Pacific a other investors are getting $30 m more to end a contract in which th ceived $9 million a year in manag fees from Burger King.

Assuming the private-equity o use part of the $600 million raised IPO to pay down the $350 millio that leaves as much as $250 millio that to the $367 m dividend and the $3 lion kill fee, and the totals $647 million, double their origin vestment. It's all go the owners, but King ends up with lion in long-term de more than double t ative debt loads car rivals like McDo Wendy's, and Brands. That leaves er King in junk terr

This would b enough if the co was cooking up profits and sales But that isn't happ Burger King's prof gin for the fiscal ye ed last June was jus vs. the 5.9% earned by Wendy 12.7% at McDonald's in calenda 2005. Meanwhile, the average BK rant still generates just a little mo half the sales of a typical McDo "They've turned the train around Dennis Lombardi, executive vice dent at WD Partners, a Columbus (

LBOs to IPOs

Leveraged buyout firms are looking to flip big chunks of their investments to public investors. Here is a partial list of pending offerings:

COMPANY (PROPOSED TICKER)	BUSINESS	LEAD BUYOUT FIRM
J. CREW GROUP (JGC)	Apparel and accessories	Texas Pacific Group
GOODMAN GLOBAL (GGL)	Heating, ventilation, products	Apollo Management
MERRILL CORP. (MRLL)	Business services	DLJ Merchant Banking
PROGRESS RAIL SERVICES (not available)	Locomotive and rail-car maintenance	One Equity Partners
SEALY (ZZ)	Mattresses	Kohlberg Kravis Roberts

Data: Hoovers.com, company filings

Have It Whose Way?

Many private-equity firms, including Texas Pacific, follow the same playbook to extract big profits from the companies they acquire:

BORROW BIG-TIME Private-equity firms use heavy amounts of debt to minimize the cash they have to invest. For its $1.5 billion acquisition of Burger King, Texas Pacific is believed to have invested just $325 million of its own money, borrowing the rest.

PAY YOURSELF Private-equity firms aren't shy about pulling special dividends and fees out of their companies. Texas Pacific recently charged Burger King $30 million to end its "management contract" and took out loans to pay itself and its partners a "special dividend" of $367 million.

GO PUBLIC AGAIN Firms usually take the company public again within a few years, reaping large paydays. When Burger King goes public, Texas Pacific and its partners will have already nearly doubled their original investment. Not a bad result for about three years' work.

Data: SEC filings; *BusinessWeek*

estaurant development firm. "But sure it's out of the tunnel."

fair, Brenneman, who helped get ntal Airlines airborne again dur- 1990s, hasn't exactly been sitting watching the grass grow. A hard- son of Mennonites, who spent rs as a teen shoveling hay on his ther's Kansas wheat farm, Bren- got busy the moment he became August, 2004. The goal was to go y 2006, so Brenneman had little show results.

/ PROFITS

VE INTO the job, getting new s such as Chicken Fries, the An- ak Burger, and the Tendercrisp sandwich out into restaurants. To orale and improve communica- h the troops, Brenneman, 44, de- lksy voice mails every Friday, up- mployees and franchisees about t results and initiatives.

ng franchisees earn more money ther priority, so he boosted group ing and commissioned the design aller prototype store that is more % cheaper to build. And to solidi- er King's standing with highly "superfans"—men aged 18 to nneman rolled out a new male- ad campaign that depicts the ascot playing in NFL games.

nitiatives seemingly have paid off: rning just $5 million in the fiscal ded June, 2004—Texas Pacific's year of ownership—Burger King l profits of $47 million in the fol- 2 months.

or a company that raked in $1.9 n revenues in its last fiscal year, pretty skimpy return. And it's fair hether Burger King achieved its numbers by whacking advertising. According to TNS Media Intelligence, a New York media-tracking service, Burger King spent $268.7 million on national advertising in 2005. That's $54 million less than the year before and $120 million less than in 2002, the last year Diageo owned the company, albeit with slightly more restaurants. Had Burger King spent what it did in 2004, its $47 million profit would have been lower.

Brenneman & Co. also claim that sales at stores open more than one year—a common industry measure—have been rising steadily for seven straight quarters. But heads turned in restaurant industry circles when Burger King last year started reporting sales on a quarterly basis instead of monthly. Many chains, including McDonald's, report same-store sales every month. And some analysts wonder whether Burger King's switch was an attempt to mask a sales drop during some months. After a 6.7% rise in same-store sales during April, the last month that Burger King disclosed monthly numbers, the company reported second-quarter sales rose just 1.8%, suggesting that sales were negative in May or June.

It doesn't help matters that Burger King's relations with the chain's franchisees have been less than stellar. While some praise Brenneman for his efforts to boost sales, others complain that Texas Pacific hasn't done enough to help struggling operators get back on their feet. They and their lawyers say Burger King has pushed struggling franchisees who filed for bankruptcy protection to close their underperforming stores and go out of business.

Matters grew so acrimonious that, last October, the company severed ties with the National Franchisee Association Inc., which represents the operators of about 6,000 Burger King restaurants. In a letter to the association, John W. Chidsey, Burger King's president and chief financial officer, blasted the group's leaders for failing to support plans to expand hours, promote a value menu, gift cards, and other initiatives.

OPPORTUNE TIMING

IN THE MONTHS SINCE, Burger King has tried to sideline the NFA by holding separate discussions with the franchisees it deems more cooperative. The company began talking to the NFA again in February. The group's new head, Joseph D. Anghelone, praises Brenneman and his team as being "very professional and dynamic," but he notes that Burger King is still in arrears on $1.7 million in support payments owed to the association. Burger King in its prospectus says relations are improving.

In the end, the Burger King IPO will likely succeed. Given the heavy demand for the IPOs of Chipotle and Tim Hortons, some investors think Texas Pacific picked an opportune time to begin unwinding its stake in the fast-food chain. "I've learned to never bet against Texas Pacific," says Peter L. Goldman, a portfolio manager at Chicago Asset Management Co., which oversees $750 million in investor funds. "They've created value in tough circumstances. Failing that, they've always succeeded in easing out of their mistakes."

But for investors, the question remains whether Burger King's owners have truly set the company on a sustainable path or are simply trying to pawn off a business with less beef than bun. ■

–With Brian Grow and Coleman Cowan in Atlanta, Michael Arndt in Chicago, and David Henry in New York

Corporate Cash: Use It or Lose It

These and other chronic hoarders might soon be targets of shareholder activi who want the money used to boost stock prices. Tech outfits lead the list

BY MARA DER HOVANESIAN

Corporate America is sitting on a huge pile of cash. The nonfinancial companies in the Standard & Poor's 500-stock index have amassed a record $637 billion, according to S&P equity analyst Howard Silverblatt. They can deploy that money in numerous ways to the benefit of investors, whether it be acquisitions to improve their growth prospects, share buybacks to raise their earnings per share, or dividends to transfer value directly to shareholders.

But the sheer size of their hoard shows that they've been slow in putting the cash to work. Their biggest fear: making the wrong decisions with their money and raising the ire of shareholders.

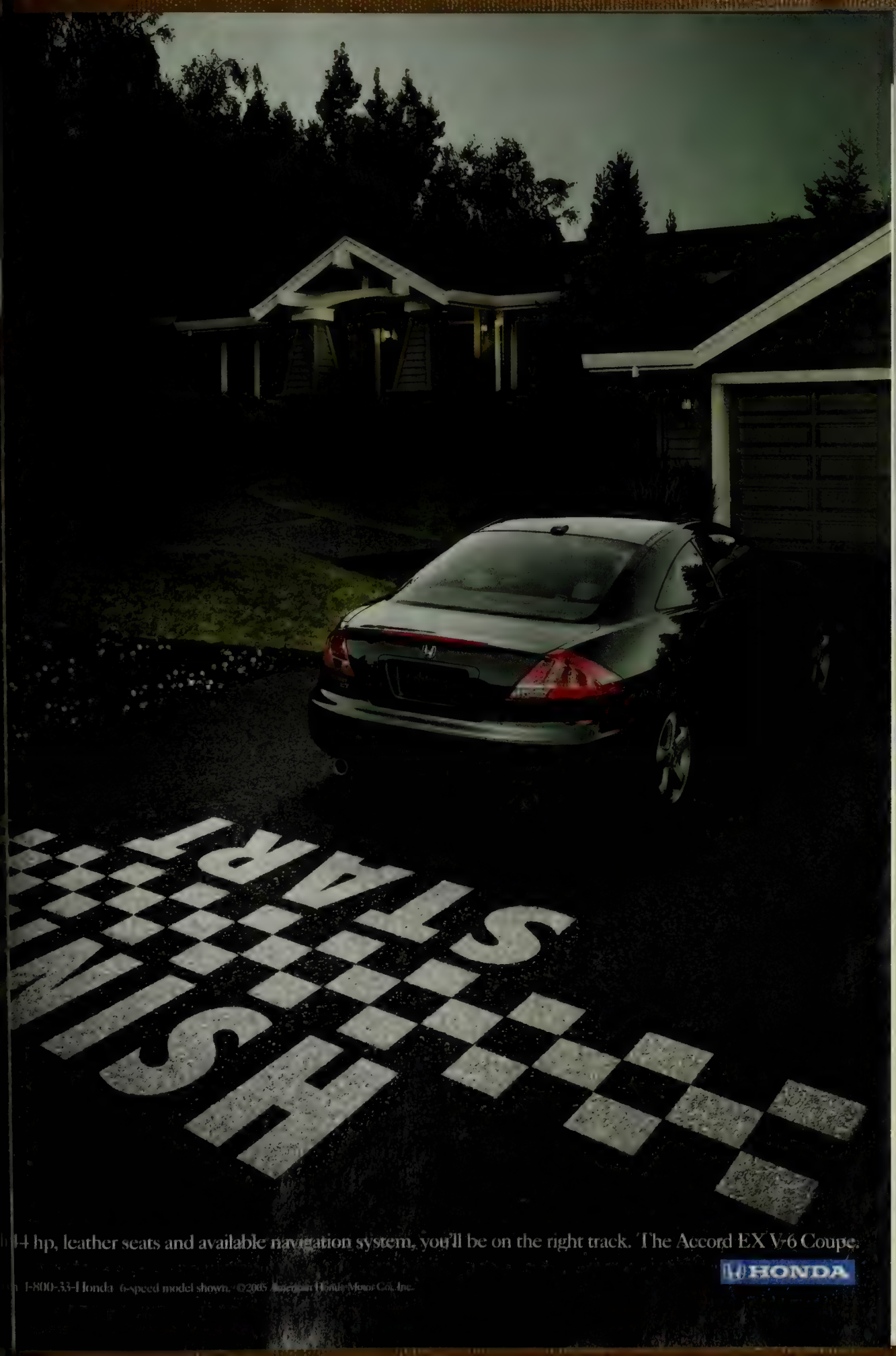
They can't sit on the sidelines forever, though. At some point, say analysts, so-called activist hedge funds, which take big positions in companies and agitate for changes, will get involved. Already, hedge fund managers Carl Icahn and Kirk Kerkorian have taken on huge companies—General Motors Co. and Time Warner Inc., respectively. It's only a matter of time before the activists start flocking to the many money piles dotting Corporate America. "Low interest rates and hefty cash balances are an extremely powerful cocktail for shareholder activism," says Morgan Stanley's chief U.S. equity strategist, Henry McVey. "I'm not arguing that management should spend the money willy-nilly, but we're coming out of a multiyear funk where investors are waking up and saying, 'wait a minute, there's great growth [potential] out there.' "

The accompanying table shows the companies in the S&P 500 with the most cash on their books as a percentage of their total market value. Note the healthy dollop of technology companies on the list. Nicholas Colas, director of research at Rochdale Securities LLC and a former analyst at hedge fund SAC Capital Advisors LLC, explains that tech companies' cash balances are typically greater than those of the average S&P company by a factor of three. But while "there's a constant challenge to keep investing that cash intelligently," he says, "they've got to start doing something with that money." Before long, they may have no choice.

COMPANIES*	MARKET CAP AS OF 3/28/2006 (MILLIONS)	CASH AS OF MOST RECENT QUARTER (MILLIONS)	CASH AS A MARKET 3/28/20
NOVELL	$2,979	$1,686	57
COMVERSE TECHNOLOGY	4,747	2,325	49
SANMINA-SCI	2,267	1,039	46
LOUISIANA-PACIFIC	2,905	1,325	46
SOLECTRON	3,554	1,527	43
CMS ENERGY	2,883	1,045	36
INTERPUBLIC GROUP OF COS.	4,270	1,349	32
COMPUWARE	2,970	830	28
PMC-SIERRA	2,270	628	28
MOTOROLA	54,489	14,785	27
UNISYS	2,373	643	27
HASBRO	3,732	942	25
QLOGIC	3,073	719	23
KLA-TENCOR	9,617	2,227	23
ELECTRONIC DATA SYSTEMS	13,954	3,220	23
U.S. STEEL	6,676	1,479	22
LSI LOGIC	4,378	939	21
SEARS HOLDING	20,891	4,440	21
APPLIED MATERIALS	27,977	5,808	21
EASTMAN KODAK	8,257	1,665	20
ANALOG DEVICES	13,569	2,735	20
NOVELLUS SYSTEMS	3,229	649	20
GAP	15,766	3,042	19
TELLABS	7,170	1,371	19
BMC SOFTWARE	4,561	862	19

Data: Rochdale S

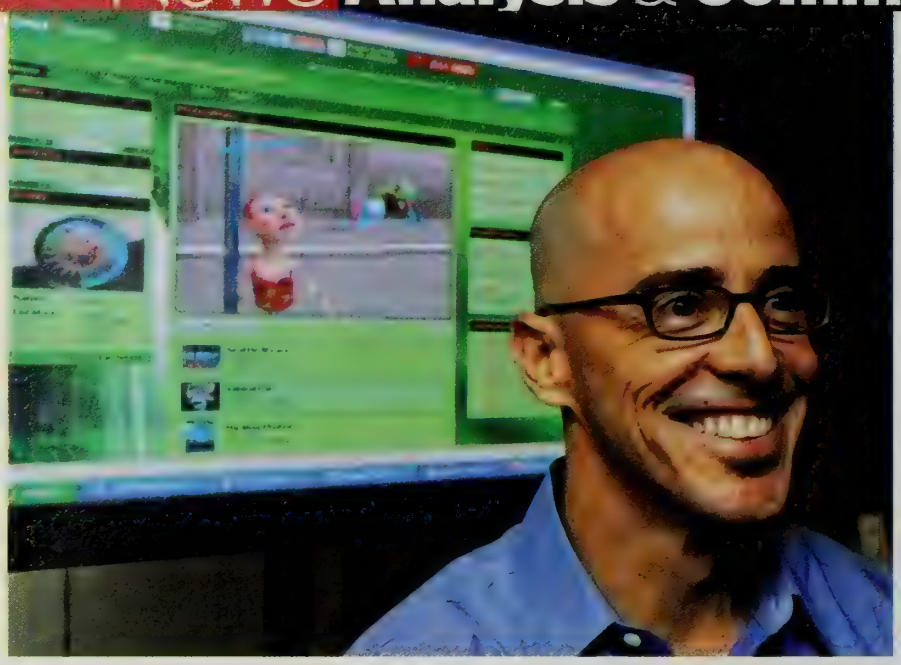
*Companies in the S&P 500 with earnings growth and positive free cash flow. Excludes health-care and financial companies.



h 14 hp, leather seats and available navigation system, you'll be on the right track. The Accord EX V-6 Coupe.

HONDA

h 1-800-33-Honda 6-speed model shown. ©2005 American Honda Motor Co., Inc.



CONNECTIONS
VP Irving wants the Web to feel linked to the PC

ONLINE SERVICES

KEEPING UP WITH THE GOOGLES

Microsoft's next Windows version is hung up, but its cool Web services are flowing freely

BY JAY GREENE

THE DELAY OF MICROSOFT Corp.'s Windows Vista operating system until next year makes the software giant look like a dinosaur stuck in the tar, but that's not the whole picture. Its efforts to match the Googles of the world with fast online innovations seem to be paying off. In the five months since Microsoft announced its Windows Live strategy, it has released no fewer than 20 new services that are attracting millions of consumers. "They now gain some of that agility that Google has enjoyed," says analyst Van Baker of researcher Gartner Inc.

What exactly is Live? It's a set of technologies designed to blend the programs people run on their computers, such as Windows or e-mail, with the things they do out on the Web. Live.com, for instance, is a next-gen Web portal loaded with services such as Windows Live Expo, where people can search classified ads on the Web and compare notes on bargains with people on their instant messenger buddy lists. Live "makes it feel like the Web isn't a place where you go to. It's linked [to desktop computing].... And it's very personal," says Microsoft Vice-President Blake Irving.

That combination of PC and Web services is already drawing regulatory scrutiny. European Union Competition Commissioner Neelie Kroes wrote to Microsoft Mar. 29, expressing concerns that Vista could limit consumer choice by giving Microsoft's own programs advantages over the alternatives. The letter raises the specter of an EU investigation prior to Vista's launch in Europe. Microsoft's reply: Consumers will continue to be able to choose whatever programs they like.

The Live strategy creates a new business model for Microsoft. For starters, the company is revamping its approach to software development. The core technology inside dows still take years velop and u but Micros committed to popping out pieces ware—such as its latest photo technology—as soon as they're Photo editing upgrades would be matically downloaded from the W could be connected to online storage sites that could generate re

The other big shift is in how Mi gets paid. Online ads are its new sion. The company's executives g in the world where they sell softw the box, a business that's growing these days. While Microsoft has lo lied on advertising to support it Web portal, it's now selling ads m gressively and in new ways. It has placing ads within the Live service it's experimenting with homegrow nology that lets users turn down types of ads but request more of Piper Jaffray Cos. analyst Safa Ra estimates online advertising will t billion globally by 2010, which tra to 27% compounded annual grow

There are plenty of unanswere tions about the Live strategy, h Microsoft's ad technology is unpr trails both Google and Yahoo! i search, and that may keep advertise paying top dollar. What's more, the for many of Microsoft's new ser untested. So far, the appeal appear ed to Web enthusiasts who write bl have multiple e-mail accounts. Ri adding mainstream applications word processors and spreadsheets, alysts don't expect Microsoft to off ices that compete with its Office ca

Still, Microsoft ha something. It's un creasing pressure t its traditional PC s relevant even as it into new online m Live is off to a soli even impressing s the Web up-and- "Microsoft is startin it," marvels Jeff Mel ecutive vice-presid startup YouOS, whi launched a Web si hosts an array of services for people to tap into fro home computers or mobile devic intimidating for a company like ou as somebody who likes technol good to see." ■

–With Steve Hamm in N

THE STAT

20

The number of new Microsoft online services since November

IPUTER SECURITY

ASTY, BRUTISH, ND SNEAKY

ckers have raised the stakes with a new ; almost immune to detection

IAN GROW

AS A DATA SECURITY specialist, Jeremy Pickett sees all kinds of digital tricks. So on Mar. 20, when he was tracing the origins of a computer worm that had been l the night before from entering a computer network, Pickett wasn't prised that it tried to connect with azy Web sites, most of them, he s, in Russia. Or that it then tried to tims' PCs with as many as 30 new of "malware," ranging from spam ns to those that automatically to expensive phone-sex services. the real shock came when Pickett to test another bug by infecting his with it. Out slithered a program mptly installed itself deep inside nputer. There it became virtually e to detection from the basic anti-oftware that scans for dangerous he bug—known as a "Trojan," n turn was hidden inside a "root-as designed to activate whenever a rfer typed in a user name or pass-r bank accounts or Web sites for social networking, or e-mail. Pick-t to a bank site and entered ficti-g-in information. Right before his ose data were sent streaming back ia, joining the IDs of thousands of ims. His reaction: "absolute horror." nasty bit of code, appropriately "the Hearse" by Pickett's employ-Security Inc. in San Mateo, Calif., tening to raise the stakes in the spy war over cybercrime. That's the average computer security n sifts for known worms and on PCs. But rootkits cloak data-code so that it can hide in the guts of Windows software with-wing up in task lists as an active program. Criminals, having greatly expanded their knowledge of Windows' inner workings, are flocking to this new tool. Russian computer security company Kaspersky Lab estimates that on average 28 new rootkits emerged each month in 2005, up from six per month in 2004.

Only five of 24 antivirus outfits picked up the Hearse outbreak by Mar. 21, according to virus tracker VirusTotal.com. At first, antivirus giant Symantec Corp. was not among them, though it says it detected the bug the next day. In one of the first real-time cyber stakeouts, Sana monitored one of the Russian Web sites for four days in late March. Ironically, it was left open to public view thanks to a security lapse by its unknown operators. Pickett watched as some 90,000 pieces of personal data from clients of more than 6,500 companies flowed across his screen. "It's like [Pickett] put on night vision goggles and watched," says John M. Frazzini, CEO of Secure Systems Corp. and former head of the Secret Service's Electronic Crimes Task Force in Washington. The show lasted until a Russian Web host, warned by Sana, took the site down on Mar. 24.

Equally alarming is the roster of victims, a cross-section of American business. Customer accounts for companies such as social networking site MySpace.com, auction site eBay Inc., credit-card and banking company Capital One Financial Corp., and Internet service provider AOL Inc. were compromised, *BusinessWeek* learned. Names and passwords from over 2,000 MySpace accounts were stolen. Spokeswoman Dani Dudeck says the company "takes user privacy and site security very seriously and quickly responds to all potential threats."

Many companies, though menaced anew every day, still don't have systems in place to react quickly to warnings. When Pickett and co-workers contacted some of them, they received automated e-mail responses or had to call multiple people. One unnamed company reported Sana officials to its nuisance department. Some moved faster. EBay quickly blocked compromised accounts until new passwords could be set. Bank of America Corp. officials immediately contacted the Secret Service's Criminal Investigative Div.

And the Hearse? Analysts suspect the hackers simply moved to a new, undetected collection spot. Warns Sana CEO John Zicker: "How deep does the rabbit hole go? Did we get there? No." ■

What a Scam

The Hearse outbreak allowed thieves to steal user names, passwords, and bank accounts. The toll:

90,000	37,000	6,500
Pieces of personal data stolen	Online accounts compromised	Companies hit

Data: *BusinessWeek*

BusinessWeek weekend To learn how you can protect your financial info from hackers, watch BusinessWeek Weekend. Check your local TV listings or go to businessweekweekend.com

INSIDE STORIES

CASHING IN ON THE KATRINA CLEANUP

Why the Army is about to hand an Indian tribe an enormous no-bid contract

BY DAWN KOPECKI

THE MISSISSIPPI CHOCTAW Indians are looking for another way to work Washington—this time, through the Pentagon. You remember the Choctaws: The wealthy tribe got national notice last year as one of Jack Abramoff's biggest clients, paying the disgraced Republican lobbyist and his business partners more than $27.6 million to sway lawmakers on gaming issues. In Abramoff's recent plea agreement, he admitted to bribing members of Congress by funneling millions from the Choctaws and other tribes through charities.

Now the Choctaws are poised to receive a $300 million no-bid federal contract for post-Katrina cleanup in Mississippi. They are bereft of Abramoff's counsel: He was sentenced on Mar. 29 to nearly six years in prison and faces up to 30 more years for the charges involving the Choctaws. Yet the tribe has capitalized on contracting laws that favor Native Americans and on Congress' political pressure to steer Hurricane Katrina cleanup cash to home state companies. According to e-mails and documents reviewed by *BusinessWeek*, top Republicans led by Mississippi Senator Trent Lott have been leaning on the Army Corps of Engineers to replace AshBritt Inc., the big cleanup contractor based in Pompano Beach, Fla., with smaller home state firms.

The Corps thinks it has found the answer: IKBI Inc., the Choctaws' federal contracting subsidiary. A wrinkle in federal procurement rules designed to help Native Americans lets the Army forgo the usual competitive bidding process to award all $300 million in work to the Choctaws as a sole-source contract.

The downside? The Choctaws' new contracting company has just seven employees and has never won a federal contract, according to the Small Business Administration. What's more, IKBI plans to subcontract much of the work to a large white-owned outfit in Tennessee.

Neither the Choctaws nor IKBI would comment for this story. The tribe is one of Mississippi's largest employers, operating casinos and other businesses, including a company that makes automotive wiring for Ford Motor Co. The Choctaws are the second-largest donor to federal campaigns among Indian tribes. But

IN BILOXI Cleanup profit margins could be as high as 25%

their direct gifts to Lott, $27,00 1999, are relatively small.

Controversy has clouded the cleanup ever since Katrina and Rita their one-two punch on the Gulf Mississippi politicians were quick cize AshBritt, a company with tie Bush Administration and Mis Governor Haley Barbour's former ing firm, which won a $500 millio gency job to remove debris in the s

Mississippi lawmakers, led by I Representative Charles W. Picke (R-Miss.), urged federal agencies money to in-state companies. Sor of AshBritt's subcontractors are b Mississippi. But less than 6% prime contracts had gone to local

Steering the prime contracts state companies helps lawmakers ways. First, prime contractors more money. "The difference i between the prime contractor a contractor is significant," said Bri ry, spokesman for Pickering. AshBritt nor the Corps would the company's profits. But Pick staff estimates that AshBritt's margin could be as much as 25% ey that an in-state contractor coul Second, subcontracts don't re same attention as prime contract

The Corps began looking for rebid AshBritt's contract soon afte awarded in September. E-mails b the Pentagon and the Engineering

Anatomy of a Loophole

The Mississippi Choctaw tribe could land a sole-source contract worth up to $300 million to clear debris from Hurricanes Katrina and Rita. Here's how:

THE LOOPHOLE Special breaks under the Small Disadvantaged Business (SDB) program for companies owned by tribes.

HOW IT WORKS Companies owned by Native American, Alaskan, or Hawaiian tribes can bid with no competition on designated federal contracts of any size. Other minority-owned SDB companies face tighter limits.

WHAT IT'S WORTH Tribal companies got $1.8 billion of the $19.5 billion in SDB contracts issued in 2003.

WHO WINS The Choctaws will get the contract, but most of the work will be subcontracted to a white-owned Tennessee company.

contracting office in Vicksburg, Miss., cited intense pressure from local lawmakers. Colonel Norbert Doyle, the Corps' top contracting official, noted in an Oct. 20 e-mail, "The [Mississippi] staffers raked us over the coals."

The Army decided to pursue an aggressive plan to cut out AshBritt and divert the remaining Mississippi cleanup money to local outfits. "The reason we are separating it out is because of the political pressure to get rid of the 'big' out-of-state contractors and award contracts to smaller firms," a top procurement officer told Doyle in an e-mail dated Oct. 25.

The Corps dusted off a little-used law called the Stafford Act to prohibit state contractors from bidding. tt CEO Randy Perkins filed a legal ge. "This procurement in itself thing but charades," Perkins says. overnment Accountability Office l AshBritt's protest on Mar. 20; npany plans to appeal. But under rules for companies owned by he Corps can place a contract of e with IKBI without competitive g. It created a so-called bridge t worth up to $300 million for cording to sources familiar with tract.

an-owned companies can place k—and the money—with what- subcontractors they want. lle-based Phillips & Jordan Inc. s that it is the lead subcontrac- IKBI's bid. Corps officials note contract has yet been awarded. now we're trying to figure out our options are," says Corps man Michael Logue. He would- firm or deny that IKBI is the contender.

Mississippi companies hired by t to do the actual cleanup work o be bumped. "This Indian com- just going to sub the whole con- an outsider, which defeats the purpose," said Richard Rula, nt of Hemphill Construction Florence, Miss. "Out-of-state is state, last time I checked." ■

With Eamon Javers in Washington

FOOD FIGHT

ALFALFA SPROUTS, AISLE 78

Wal-Mart's move into organic foods has small farmers and the health-conscious bristling

BY PALLAVI GOGOI

ORGANIC IS HOT. YOU might think this would make small organic farmers happy. Well, they're not. Giants such as Kraft Foods Inc. and Dean Foods Co. have grabbed a large chunk of the market, and now retail juggernaut Wal-Mart Stores Inc. plans to double its selection of organic offerings. "Wal-Mart has the reputation of beating up on its suppliers," says Richard DeWilde, an organic farmer who grows Swiss chard, parsnips, turnips, and kale on 100 acres in Wisconsin. "I certainly don't see 'selling at a lower price' as an opportunity."

Price pressure isn't the only thing that worries DeWilde. He and other farmers fear that the corporate giants could try to water down the standards for what is classified as organic food, which would facilitate more imports. "Wal-Mart already sources a majority of its products from China. Why not foods?" asks Ronnie Cummins, director of the Organic Consumers Assn. (OCA), a nonprofit group that promotes natural and organic food.

Wal-Mart didn't return phone calls seeking comment. But CEO Lee Scott has been clear about his company's goals. "We don't think you should have to have a lot of money to feed your family organic foods," he said at the company's annual meeting last year.

It's easy to see why the big boys are salivating over the organic market. It has grown 20% annually for five years, compared with 3% to 4% for the industry as a whole. And it's highly profitable. According to an OCA study, consumers are willing to pay 50% more for foods that have not been genetically modified.

Import worries are not unfounded. Cummins estimates that 10% of organic foods like meat and citrus come from abroad. Dallas-based Dean Foods, the biggest U.S. milk producer, buys organic soybeans from China and Brazil to make its best-selling Silk-brand soy milk.

AMY CONN-GUTIERREZ/AP/WIDE WORLD

Big squeeze: Purists fear the food chains will water down standards

Anxiety about standards is also legit. Large companies have already flexed their muscles in Washington. Last fall, the Organic Trade Assn., which represents companies like Kraft and Dean, lobbied to allow certain synthetic food substances in the preparation, processing, and packaging of organic foods. That outraged organic activists. Nevertheless, the bill was approved, and the new standards will go into effect later this year. ■

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Decide with Confide

nmigration Reform: Why usiness Could Get Burned

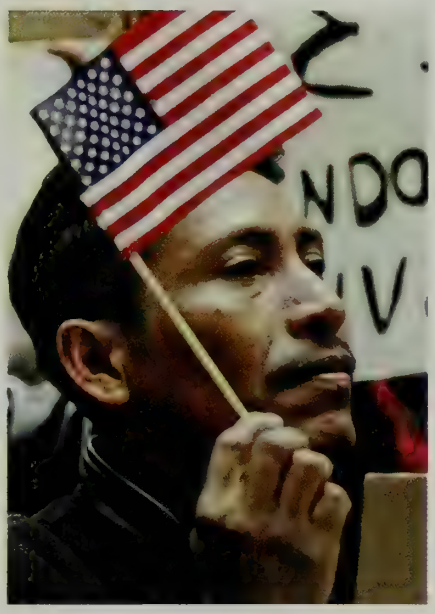
HARD S. DUNHAM

IMPORTANT IS IMMIGRATION TO THE BUSINESS nunity? Very. On Mar. 16, Bill Gates trekked to Capitol to tell key leaders of both parties that immigration crosoft's No. 1 issue in Washington. "If we hope to tain our economic and intellectual leadership in ., we must renew this commit- Gates said in an earlier letter to ers. "Unless there is reform, an competitiveness will suffer as untries benefit from the interna- alent that U.S. employers cannot retain."

ides Now

AND HIS FELLOW CEOs have ason to be nervous. Politicians in rties are seizing on public concern 2 million illegal immigrants living U.S. to craft legislation limiting order mobility for skilled and un- workers alike. And while corpora- re accustomed to anti-business s from the Left, they are now a defensive battle against angry t Republicans who want to seal der and punish companies that illegals. At the Conservative Po- Action Conference in February, ntative Tom Tancredo (R-Colo.) anding ovation for skewering com- that profit from imported labor. nservative movement can either be e of principle or it can be the voice hamber of Commerce," Tancredo "But it cannot be both."

g rhetoric like that, many corpora- l pressured. By opposing the GOP's nigrant faction busi- s the risk of ushering Democrats in the ctions. But Tancredo allies pose a more im- threat to business' n need for a steady f foreign workers. mmigration hardlin- serious penalties to usinesses think twice hiring immigrants. ion approved by the House in late 2005 would make it a felony for businesses to hire illegal workers: Companies that incorrectly fill out certain paperwork on employees could be fined up to $25,000. "It doesn't take too many of those [fines] to drive a small business out of business," says John Gay of the National Restaurant Assn.



SHOW OF LABOR FORCE Protesting in Trenton, N.J.

Business is doing better in the Senate. Corporate lobbyists believe they have the votes to water down the tough financial penalties and win their top priority, a guest-worker program that lets foreigners take jobs Americans don't fill.

> One new proposal could cost employers $12 billion in compliance

But the prospect of a House-Senate negotiation has the business community on edge. A compromise is likely to include language requiring companies to confirm the legal status of all employees and prospective hires. Angelo I. Amador, the U.S. Chamber of Commerce's immigration policy director, says that plan would be a bureaucratic nightmare costing employers at least $12 billion for compliance. The current federal pilot program to confirm whether employees are legally in the U.S. has been unreliable, he adds.

Yet business must tread carefully to avoid angering GOP immigration foes. "I'm worried that the clearly harsh voices in the Republican Party are the loudest voices," says former House Majority Leader Dick Armey (R-Tex.), leader of a pro-business coalition. Business frets that populism could foster a GOP faction hostile to such corporate priorities as trade liberalization and tax breaks. Already, the political schism has sparked showdowns in Republican primaries between anti-immigrant candidates and business community favorites. Among the contests: the San Diego district long represented by convicted ex-congressman Randy "Duke" Cunningham and the districts of retiring Republican Representatives Butch Otter of Idaho and Jim Kolbe of Arizona.

Business is digging in for a long battle. "This is a long-term issue, because this is a workforce issue," says Bernadette Budde, senior vice-president of the Business Industry Political Action Committee. "We're going to have to find labor someplace." But corporate critics don't cut companies any slack. "The illegal immigration lobby in the U.S. is big business," says Tancredo spokesman Will Adams. "They have an addiction to cheap labor."

With struggling President Bush mired in an unpopular war, GOP discord over immigration is just one more threat to the party's grip on Congress this fall. Democrats, says independent political analyst Charlie Cook, "have settled into their seats with popcorn to enjoy the spectacle of Republicans ripping themselves apart." That's a lot easier than coming up with a solution to this divisive issue.

TURNAROUNDS

ANYTHING BUT STODGY

Barclays' Bob Diamond has turned the once-troubled investment banking unit into a powerhouse

BY STANLEY REED

BOB DIAMOND, PRESIdent of Barclays PLC, loves to tell the story to each year's crop of new managing directors. In 1997, Barclays' investment banking unit was so marginal that its centuries-old parent, Barclays, dumped most of its businesses, including equities and mergers and acquisitions. All that was left was a bond business and a few other odds and ends, rechristened Barclays Capital. British newspapers at the time quickly dubbed the unit "the rump" of Barclays. Says Diamond, an American from Massachusetts who has been running Barclays Capital since that inauspicious beginning: "That wasn't the best branding I have ever seen."

Barclays' decision to focus on the staid world of bonds seemed like a suspect move at a time when the likes of Goldman, Sachs & Co. and Morgan Stanley were thriving on initial public offerings and M&A. Yet nine years later, once-puny Barclays Capital is churning out profits that its U.S. rivals would hardly sneeze at. Diamond has parlayed Barclays into a world-leading debt, derivatives, and commodities business that has been chalking up growth in the 20% range year after year. Pretax profits at Barclays Capital were up 25% in 2005, to $2.2 billion, on revenue of more than $7 billion. For 2006, David S. Williams, a Morgan Stanley analyst, forecasts a 12% rise in revenues to $8.2 billion, with profits up 8% to $2.4 billion.

So far this year, Barclays Capital is the largest debt player in Europe, and the third largest globally. San Francisco-based asset manager Barclays Global Investors, which Diamond has also headed since 2002, holds the No. 1 position in exchange-traded funds, packages of securities designed to give investors low-cost exposure to anything from indexes to industrial sectors. Its pretax profits surged 61% last year, to $940 million. Barclays Capital and Global Investors accounted for about a third of overall profits last year but two-thirds of the company's profit growth.

LOOKING GOOD

OF COURSE, BARCLAYS' fortunes could change. If interest rates continue to rise, corporate issuance might slow and investors might have less appetite for its yield-enhancing products. A bigger concern would be some sudden loss of confidence in the markets—another terrorist attack, say, or a regional stock market collapse—that would chill demand for financial risk. Diamond is "smart and a good leader," says one top inve banker. "But he is not untouchable.

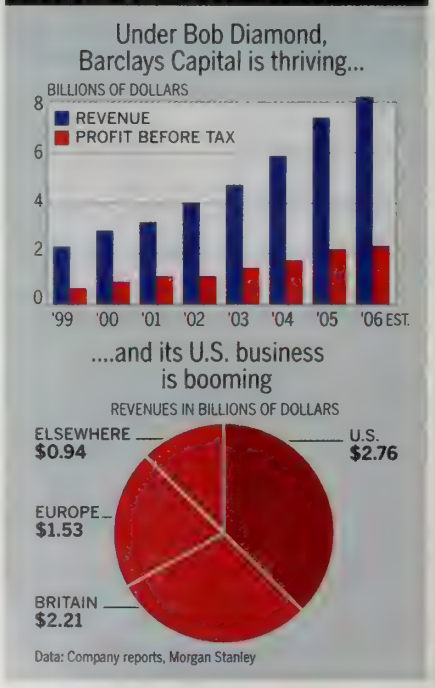
So far, he's sure looking good. Dia who came to Barclays after senior p Morgan Stanley and Credit Suiss Boston in New York, London, and is an ultracompetitive former high football star. His office at Canary W festooned with Boston Red Sox an England Patriots memorabilia. Tho know him say Diamond is a natural and teacher, traits acquired, perhap his late father, a teacher and sch ministrator whom Diamond call hero." His dad finished up his ca principal of a high school on Nan where Diamond today has a home.

Diamond, who taught manag while getting an MBA at the Unive Connecticut and who originally in to be a business school professor, culture ultimately is more essenti bank's success than products or te ogy. He has been meticulous in des the right way to hire new bankers tracking their subsequent perfor Job candidates are grilled in fou sessions and probed for flaws, esp any possible resistance to the te proach Diamond favors.

That philosophy also affects the of who will make managing directo lengthy vetting, some 30 senior exe assembled in one room vote on ea didate for managing director, usin tronic buttons. A score of 85% to 90 quired for success: Hotshots who a colleagues are told to change or lea have a 'no jerk' rule around here Chief Operating Officer Rich Ricci.

Several of Diamond's key associa also Americans, which has haster transformation of the bank's cultu from its British roots and into son much more freewheeling and en neurial. Says Diamond: "We reall lot of time and a lot of process into

BARCLAYS' BIG BANG



BOSOX BANKER
Diamond has moved the bank away from its roots

everyone] based on how they per- not on who they know or how long ve been here."

urse, Diamond's decision to focus is a decade ago has also played a le in the company's success. Low rates have helped spawn vast pools lity, which have fostered a boom in innovative financial products. Companies are increasingly concerned about hedging their risks from foreign exchange exposure, fuel costs, and pension liabilities. Providing financial solutions to such problems is Barclays' meat and drink.

At the same time, investment banks such as Goldman and Morgan Stanley no longer dominate the business. Big, integrated banks such as Barclays or JPMorgan Chase & Co. have taken market share, especially in the debt markets. It's not hard to see why. The hefty, complex financings that companies demand today are sometimes not even possible without the backing of a powerful institution such as Barclays bank, which has an AA rating and a $1.5 trillion balance sheet with which to guarantee deals.

MEMORY LANE

DIAMOND IS PUTTING that firepower to good use in the U.S., where Barclays Capital's business has nearly doubled in two years, to $2.8 billion. When Barclays first tried to do business with ACC Capital Holdings in 2003, the Orange (Calif.) company's CEO, Aseem Mital, feared he would be dealing with "somewhat stodgy" types. He changed his mind after Barclays showed it could take on large, sophisticated deals for ACC, America's largest subprime mortgage originator.

Hefty, complex deals are Barclays' meat and drink

Mital particularly likes a complex securitization dubbed "memory lane," which allows his company to gain cash in advance from its $80 billion portfolio of mortgage collections. "They have become our go-to guys," says Mital, who rewarded Barclays Capital with $12.5 billion in coveted securitizations over the last year.

Diamond is making other moves, too. Last November, Barclays entered the U.S. commodities big leagues by taking a money-losing portfolio of derivatives off the hands of Charlotte (N.C.)-based Duke Energy Corp. for $700 million. In the Middle East, it helped raise $10 billion for Dubai Ports World's recent acquisition of Britain's P&O. Part of the financing was a $3.5 billion "sukuk," or convertible bond issue designed to conform to Islamic strictures against charging interest. When Deutsche Bank missed its deadline, Barclays won two-thirds of the deal, and an extra $30 million in fees.

Is there more he can accomplish at Barclays? Diamond says: "That is the right question, and it is scary." His name came up when Morgan Stanley was looking for a CEO last year, and he is likely to be on the short list for other top jobs. Diamond insists he's happy right where he is. Whatever happens, he won't be running a rump business anymore. ■

RUSSIA

A DEAL BOTH TEMPTING AND TROUBLING

Oil giant Rosneft has vast reserves, but its controversial past has investors wary

BY JASON BUSH

IMAGINE AN OIL COMPANY THAT has in five years seen its annual production and profits grow to six times their former size, making it one of the world's largest energy giants, with more proven oil reserves than Exxon Mobil Corp. Now, suppose that at a time of near-record oil prices the company plans to sell up to 49% of its shares in an initial public offering worth some $20 billion. Investors would be champing at the bit, right?

Not necessarily. The company is Rosneft, Russia's state-owned oil giant. While it looks mighty impressive on paper, Rosneft has some skeletons in its closet that may give investors pause. With close Kremlin ties (its chairman is President Vladimir V. Putin's deputy chief of staff), Rosneft shot to prominence in 2004 when it acquired key oil assets of Yukos, the company that was hobbled after then-Chairman Mikhail Khodorkovsky was jailed on charges that defenders claim were politically motivated. The affair wiped out the value of Yukos, costing investors billions of dollars.

So Rosneft CEO Sergei M. Bogdanchikov has been pulling out the stops to impress investors. He's making the rounds of world financial centers, hinting at listings in London, New York, Frankfurt, Tokyo, and Moscow. And he's been looking for an experienced Western manager to bolster Rosneft's image. He's set to appoint Morgan Stanley's co-head of investment banking in Moscow, Peter O'Brien, to a senior position with responsibility for the IPO. (Former Commerce Secretary Donald L. Evans declined a top Rosneft job last year.)

It's all a sign of how much Rosneft—and Putin's Kremlin—have riding on the IPO's success. The company is $11 billion in debt, and a $7.5 billion loan to its holding company from Western banks expires this year. The Kremlin makes no secret of its ambition to boost the value of its big state energy companies, Rosneft and natural gas provider Gazprom. In Rosneft's case, to make that happen, the company needs to get beyond its controversial past. Now, says former Putin economic adviser and current Kremlin critic Andrei N. Illariono main aim of the Rosneft IPO "is to l so-called Western stamp of appro all this business [with Yukos]."

The Yukos acquisition transfo Rosneft from a relatively obscure pr er to a 1.5 million-barrel-a-day gia 15 billion barrels in proven reserv second only to Russian peer l among listed oil companies. V more, Rosneft's fields are rela young, giving it good growth pros "If you look at Rosneft's oil asset p lio, it is perhaps the best in Russia, Kaha Kiknavelidze, an oil and gas a at investment bank UBS in Moscow

REFLECTION The oil giant is looking West to bolster its image

Rosneft At a Glance

The Russian oil giant's IPO could raise $15 billion to $20 billion. Here's what investors are buying:

PROVEN OIL RESERVES **15 billion barrels**
OUTPUT **1.5 million barrels per day**
REVENUES* **$24 billion**
NET INCOME* **$4 billion**
NET DEBT **$11 billion**
EMPLOYEES **54,300**

*2005

Data: Rosneft, Deloitte & Touche, *BusinessWeek*

AMBITIOUS GOALS

BUT SHADOWS OF the Yukos linger. "If Rosneft had grown in mal manner, people would be rush snap it up," says Stephen O'Su head of research at Moscow inves bank Deutsche UFG. "The issue potential legal overhang from Y On Mar. 15 a consortium of intern al banks initiated bankruptcy pr ings against Yukos. Rosne already bought much of Y debt, and will probably gr company's remaining ass Russian authorities d Yukos bankrupt.

Another imponderabl whether Rosneft can achi ambitious performance go 2010, the company aims crease its oil production b to 2 million barrels a day. praise CEO Bogdanchikov' agement, noting that even Rosneft's acquisition o Yukos oil fields he boosted al production by 74% be 1999 and 2004. Helped high quality of its assets, R also has some of the lowes in the industry. But critic that production has beer nant at most of its majo sidiaries since 2000 and t company's pretax earnin barrel last year were 30% than those of rival Lukoil.

It's not yet clear how in will react to a Rosneft o Much will depend on h management team choo structure the upcoming de time when oil seems scarc neft, at the right price, mi hard to pass up, even for in already buffeted by the s winds of Kremlin politics.

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INDIA

MAKING BANGALORE SOUND LIKE BOSTON

Overseas call centers turn to e-mail and chat to handle frustrated U.S. customers

BY PETE ENGARDIO

HARI KISHAN READILY admits that he's not the best guy to put on the phone with impatient Americans. With his heavy South Indian accent and rapid, abrupt cadence, Kishan knows U.S. customers have a tough time understanding him. In any case, he says, he's "not the type of guy who likes to talk a lot."

So what is he doing processing orders for a U.S. retailer? Like growing numbers of call center agents in India, he doesn't talk. He types. Put the 26-year-old computer science grad at a keyboard, and he might as well be in Peoria. "Welcome to our wireless world," Kishan chirped to open a recent online conversation from MphasiS BFL Ltd.'s huge call center in Mangalore. He calmly tapped out crisp answers to a battery of questions from a U.S. customer frustrated that he hadn't received a cell phone he had ordered. The conversation, Kishan learned later, was a test set up by his employer with a reporter—and he passed with flying colors.

Demand for such skills is growing fast as Americans become increasingly hostile to overseas call center agents. Even if the service is actually the same as or better than what's offered by U.S.-based call centers, many Americans are turned off by foreign voices. Some 62% of U.S. consumers gripe about service if they suspect the agent is overseas—double the dissatisfaction rate with calls to agents they think are in the U.S., according to a study by Opinion Research Corp. "Irritation kicks in when [customers] hear the accent," especially if they're already having a problem, says MphasiS Vice-Chairman Jeroen Tas. And a study by Convergys Corp., the world's biggest call center operator, with 66,000 workers in 30 countries, found that 72% of U.S. consumers claim they would rather use automated voice systems or the Web than speak with a foreign agent.

THE STATS

69%	62%
of Americans say they're less likely to do business with a company after a bad call center experience	say their most recent experience with an overseas call center agent was disappointing

Data: Opinion Research Corp.

Such perceptions matter. Nearly 7 in 10 consumers say they are less likely to do business with a company after a bad call center experience, Opinion Research says. One U.S. toy retailer told the company it pulled all of its call-center work fr dia and the Philippines after frus buyers came into stores complainir they couldn't understand the agents. "They saw a real risk of e their brand," says Opinion Resear nior Vice-President Linda Shea.

So companies are trying alternat voice calls—including online chat, and improved automated voice s that can resolve problems more q Such services account for less than consumer inquiries today, but thei is projected to double in five years based service is a popular alternat cause agents such as Kishan can accurate typists and h perb technical know Many have spent instant-messaging buddies in English. "eliminates the acc sue," says David A. Ste CEO of InPhonic In Washington (D.C.) on tailer whose calls handles. Online servi also be cheaper, since can handle two or thr versations simultar while they wait for res from customers.

CULTURAL CUES

THAT HAS CALL cen erators devoting gre sources to chat. As wi phone agents, Mphas newly hired chat op through cultural tr They read U.S. news learn that "AAMOF" "as a matter of fact," miliarize themselves with phrases "cut to the chase." By 2008, Mph pects about 30% of its agents will e-mail and chat inquiries, vs. le 10% of its 6,500 Indian custom staffers today.

Still, voice calls aren't going to pear anytime soon. Americans whelmingly prefer to talk to a live rather than chat online or wade t automated phone menus. So com are also beefing up efforts to ne agents' accents, and have star stalling sophisticated voice analy ware to help call center personne more like Americans. But as chat-obsessed kids grow up and st ting credit-card statements, ele bills, and mortgages, expect t spend plenty more time online w likes of Hari Kishan. ■

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More than 500 top executives from around the world gathered in New York on December 1, 2005, to honor the energy industry's "Best of the Best." The Platts Global Energy Awards showcased extraordinary accomplishments from energy businesses worldwide. This year's nominees illustrate true innovative spirit and enduring commitment to customers, shareholders, and future generations.

Join us in celebrating the accomplishments of the 2005 winners:

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Phillip G. Harris, PJM Interconnection

Coal Company of the Year
Foundation Coal Holdings, Inc.

Community Development Program of the Year
National Thermal Power Corporation, Ltd.

Downstream Business of the Year (tie)
Gazpromexport
World Energy Alternatives, LLC

Energy Company of the Year
ExxonMobil

Energy Engineering Project of the Year
Tennessee Valley Authority

Energy Investor of the Year
Iberdrola

Exploration and Production Business of the Year
Anadarko Petroleum Corporation

Industry Leadership Award
GAIL (India) Limited

Lifetime Achievement Award
André Merlin, RTE Energy, Inc.

Marketing Campaign of the Year
Southern California Edison Company

Most Innovative Commercial Technology of the Year
ExxonMobil

Power Company of the Year
Iberdrola

Renewables Project of the Year
MidAmerican Energy Holdings Company

Rising Star Award
Excelerate Energy, Limited Partnership

The 2006 Global Energy Awards Call for Nominations will be issued on June 1, 2006. For more information visit www.GlobalEnergyAwards.com

The Secret Lives Of Short-Sellers

The rise of hedge funds and indie research raises new questions about a shadowy world

BY JANE SASSEEN

SITTING IN A CONFERENCE room in a Manhattan office, the researcher explains how he digs up financial information, often of the damning variety, for hedge funds and other big investors. His clients need the intelligence because they frequently sell short, meaning they bet on shares falling. "Look at the Web as a giant fish pond," he says, on the condition that he not be quoted by name. "We try to develop bait that will hook someone who knows more than anyone else."

On another day, not far away, a private investigator hired by the other side can't resist a little boast, which, of course, is not to be attributed to him. He has been employed by several companies to help prove that a group of short-selling hedge funds are fraudulently collaborating with analysts and journalists to push down stocks. He claims he has planted moles at funds and sent phony book authors to interview unsuspecting targets. "It's amazing how people just open up," he says with a grin.

SPY VS. SPY

ONCE AGAIN, the War of the Short-Sellers is surging. This time there are new twists to both public hostilities and shadowy spy-vs.-spy activity. Helping to drive the controversy is the proliferation of a breed of independent researcher prone to greater skepticism than traditional Wall Street analysts. The growing influence of these little-known characters is a by-product of the Enron-era corporate scandals, as well as New York Attorney General Eliot Spitzer's campaign against the overly rosy analysis produced by many Wall Street firms.

Businesses targeted by shorts are fighting back more aggressively with undercover investigations and lawsuits. Biovail Corp., a Canadian drug company, and online retailer Overstock.com Inc. claim that hedge funds run by two of the most powerful traders on Wall Street, Steven A. Cohen and David Rocker, have engaged in fraud to drive down share prices. (Those allegations have been vociferously denied.) Public relations campaigns related to the suits have drawn intense media interest, with CBS's *60 Minutes* featuring a sympathetic segment on Biovail. The Securities & Exchange Commission, meanwhile, is investigating allegations about abusive short-selling concerning the two companies, as well as potential underlying problems at both.

Targets of shorts are fighting back with tougher tactics

Criticism of short-sellers is as old as stock trading. The technique involves selling borrowed shares in hopes that prices fall so the shares can be bought back more cheaply before being returned. Some aggrieved executives accuse shorts of crushing shares with whisper campaigns. But shorts often expose hidden corporate weaknesses and have sounded early alarms about Enron, Tyco, Krispy Kreme, and many other debacles.

Pending suits by Biovail and Overstock allege a wider conspiracy than has been claimed in the past. One reason these complaints have resonated loudly is growing unease over the number and clout of hedge funds, the secretive, lightly regulated investment pools that frequently sell short. Since 2000 the number of funds has soared from 3,873 to 8,661, according to Hedge Fund Research Inc., while assets have more than doubled, to $1.1 trillion. "The perception is they're a bunch of cowboys, willing to do whatever it takes to get their returns," says Richard Leggett, CEO and president of the Center for Financial Research & Analysis, a forensic accounting firm whose clients include hedge funds, mutual funds, and regulators.

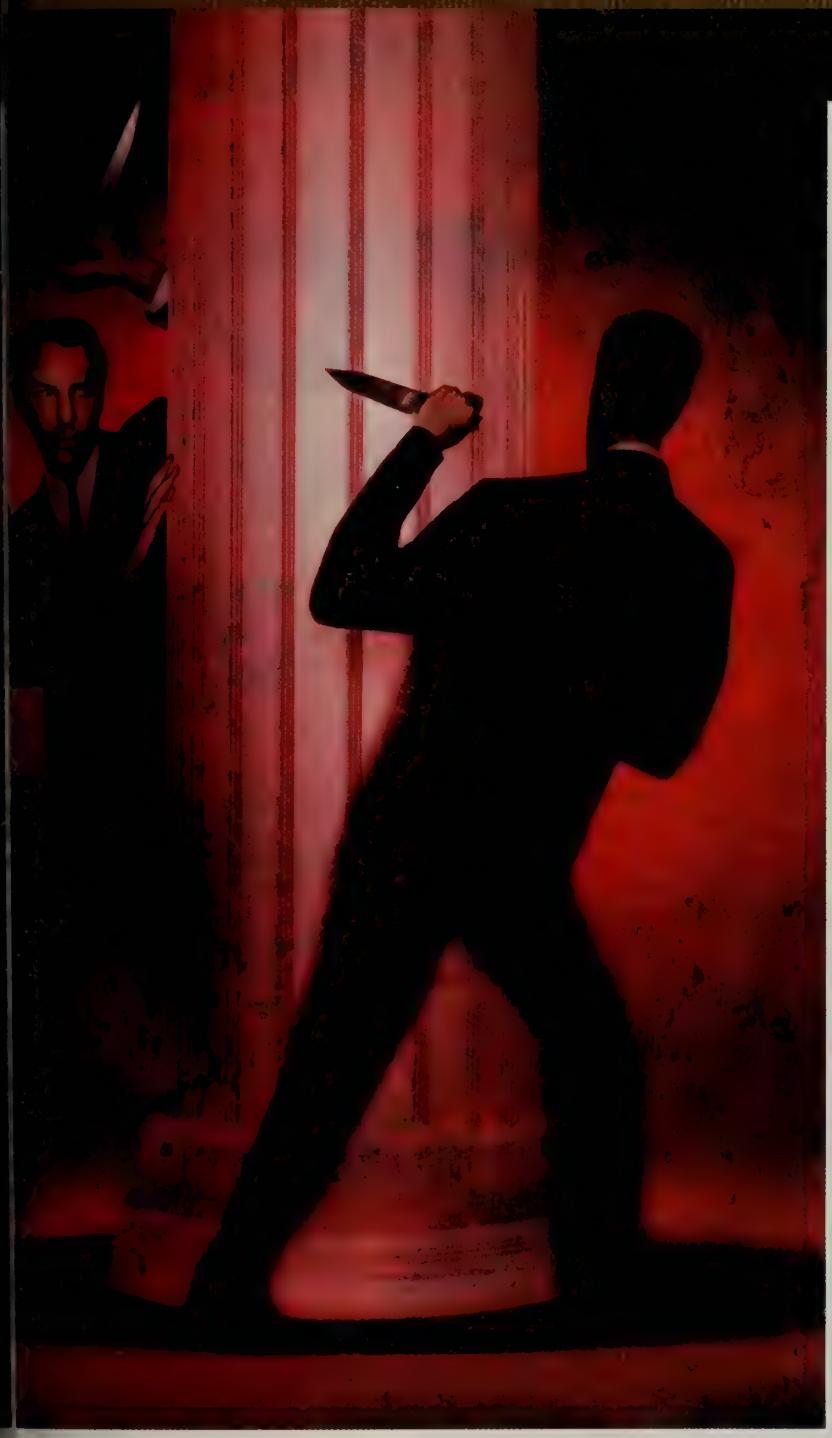
Short-selling has become much more prevalent. Hedge funds dedicated strictly to the technique, such as those run by famed short-seller James S. Chanos of Kynikos Associates LP, had $603 million in assets in 2001, according to HFR; by 2005, assets in all short-only funds had grown to $3.3 billion. Many of the thousands of hedge funds that primarily focus on "long" investing, betting that shares will rise, also short at times. Short sales on NASDAQ hit a record high of 6.2 billion shares for the month ending Mar. 15.

RABID FOR RESEARCH

THE GROWTH IN hedge funds has fueled a shift in stock research. To keep up returns, and to justify earning the highest fees on Wall Street, hedge funds have turned away from much of the research broadly distributed by investment banks. It's a commodity now. "The hedge funds will pay, but they value research that's not widely read," says Frank A. Fernandez, research director for the Securities Industry Assn., a trade group.

That trend has accelerated since Spitzer's 2002 probe of Wall Street research. One of the New York State prosecutor's goals jump-start the independent resea dustry as a counterweight to the m ment-friendly research big inve banks did. The settlement of the probe also ended the practice of a being paid to help win bankin from the companies they covered, Wall Street to cut research spendi

All that has opened the door high-priced independent comp Two specialized categories have be the most: "forensic" firms, which l suspicious accounting, and "dir search" outfits, which arrange co tial interviews with industry sourc to answer questions posed by



and other institutional investors. It s up to more research highlighting ial problems with company finan- tements or operations, and much in the hands of hedge funds that ort. Traders and analysts some- pass along such reports to the me- d that has led to harder-hitting ge of some companies.

Bi ail, in its suit filed last month in te ourt in Essex County, N.J., alleges t hen's powerful hedge fund group, $ billion SAC Capital Advisors, con- re to create false reports about the m ny's financial health with inde- nd t stock research firm Gradient An- ti Inc. of Scottsdale, Ariz. Biovail al- leges that Gradient let the Stamford (Conn.)-based SAC "ghost-write" negative reports, which Gradient sent to other clients and journalists as its own analysis after SAC had sold Biovail shares short.

Overstock has filed a similar suit in state court in Marin County, Calif., alleging that Gradient worked with Rocker's fund to push its stock down.

SAC dismisses the charges as false and says Biovail's stock fell due to regulatory problems and its repeated failure to meet earnings targets. Gradient co-founder Carr Bettis says its research is based entirely on its analysts' views, and claims that it allowed clients to sell short ahead of reports are "absolutely false." Rocker Partners LP also denies any wrongdoing, calling the allegations "frivolous."

Critics of the shorts say recent government investigations of other funds demonstrate that abuses do exist. The SEC has brought a string of enforcement actions against smaller hedge funds that sold stock short in connection with deals known as private investments in public equities, or PIPEs. On Mar. 14, three hedge funds and their portfolio manager, Jeffrey Thorp, agreed to pay $15.8 million to settle fraud and insider-trading charges related to 23 PIPEs deals. Thorp allegedly obtained unregistered shares in the private placements and shorted the stock. He then used the unregistered shares to cover those short positions, a violation of federal securities law. The defendants settled without admitting or denying charges. SEC officials say they are investigating two-dozen hedge fund players involved in such deals.

THE SILENCERS

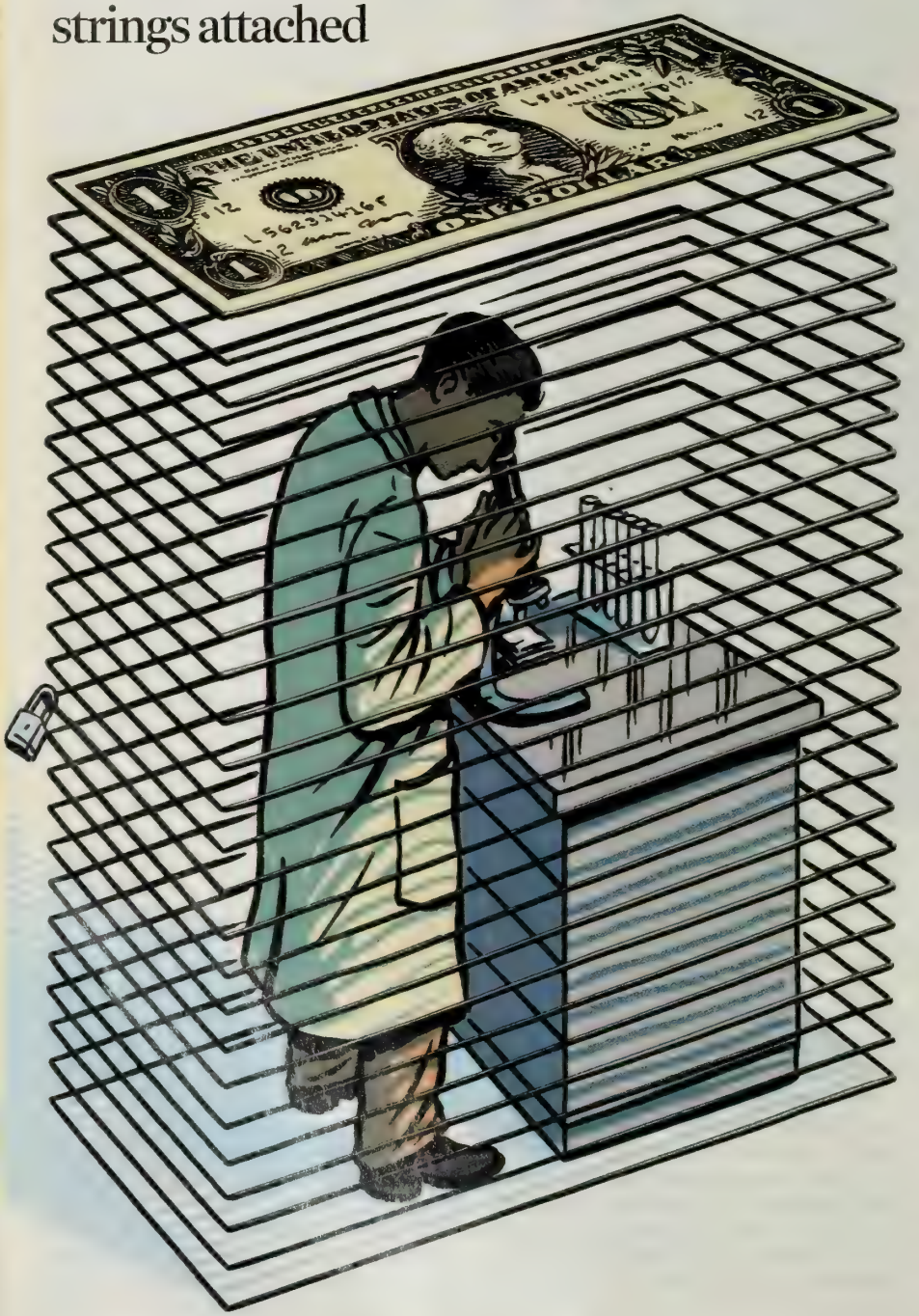
STILL, DEFENDERS OF short-selling argue that corporate critics are usually trying to divert attention from their own internal problems. Moreover, they want to silence analysts who publish critical research and discourage journalists from writing about the issues raised. "One of the more disturbing aspects of this is if they don't like what you say, then they'll use shareholder money to sue you for calling attention to their shortcomings," says Chanos, the short-seller who issued early warnings about Enron.

John O'Quinn, a plaintiffs' lawyer in Houston who has won multimillion-dollar settlements against manufacturers of cigarettes, breast implants, and diet drugs, is at the center of the escalation of the hostilities. He has coordinated an effort by a consortium of law firms over the past several years to develop cases concerning allegedly manipulative short-selling. Overstock turned to this group to press its suit in California, and Wes Christian, the day-to-day manager of O'Quinn's legal campaign, says his team has helped Biovail with its case. "When we've turned up things related to other companies, we've made sure that information got to them," says Patrick M. Byrne, Overstock's president. In this carefully orchestrated campaign, O'Quinn's group has filed lawsuits related to about nine companies in half a dozen states, Christian says. With other analyst firms and big-name funds targeted, more litigation is in the works. ■

–With Amy Borrus in Washington and Emily Thornton in New York

Biotech's Boon Or Bane?

Hedge funds are providing financing where VCs won't. But there are strings attached



BY EMILY THORNTON AND ARLENE WEINTRAUB

CASH-STARVED BIO
companies have
might politely be c
complicated relatio
with hedge funds.
sider the tension
built earlier this ye
tween troubled vaccine producer (
Corp. and its third-largest shareh
hedge fund ValueAct Capital. On M
the clash between Chiron Chief Exe
Howard Pien and hedge fund mana
Mason Morfit came to a head. At
the proposed sale of Chiro
Emeryville, Calif., to Swiss drug
Novartis, which is up for sharehol
proval on Apr. 12.

From his fund's San Francisco
quarters, Morfit fired off a letter t
ron's board declining a formal inv
to meet with Pien—unless the CEO
concede that Novartis' offer to pay
share for Chiron was "not acceptal
not, Morfit wrote, he thought Ch
CEO should be "replaced." Five day
Morfit wrote that he rejected Pien
sonal e-mail invite to get togethe
have reviewed many times the ra
for the merger... and see no purp
discussing [it] further," Morfit w
correspondence filed with the Secu
Exchange Commission. Through
mail from a company spokesmar
declined to comment on the exc
Says Morfit: "We believe the busine
turning around, and Novartis is s
to get all the upside."

The battle between biotech CE
and hedge fund manager Morfi
trates the strains caused by a c
Hedge funds are increasingly bec
major financiers and sharehold
biotech companies. In this role
funds act aggressively to boost
prices, in contrast to other situat
which hedge funds sell short, m
they make bets that shares will fall
velopment-stage biotech compan
funds are stepping into a void cre
the industry's traditional backers,
capitalists, who are growing reluc
pour millions of dollars into outf
can take decades to generate mar
products, if they ever do. Biote
ceived $3.5 billion in VC funding i
down slightly from 2004.

So biotechs are jumping into b
hedgies more than ever before.
doing so via private investments i
equities (PIPEs), or deals in which
are sold to private investors, somet
a discount to the public share pri

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through other stock and debt offerings. The amount of capital raised by biotechs through PIPEs alone, rose to $2.4 billion in 2005, vs. less than $1 billion in 2002, according to life sciences merchant bank Burrill & Co.

KNOWING THE RISKS

THE MONEY CAN come with strings attached, however. Sometimes hedge funds sell their shares immediately to lock in a quick profit, which depresses the stock price, potentially causing public investors to believe the company is in trouble. Some stock offerings are followed by bursts of short-selling, as word of the discounted deal spreads to traders who smell blood at a struggling company and go in for the kill. And sometimes, stakeholding hedge funds aren't content to sit idly by as a company struggles. They might object publicly and make other moves to undermine management.

Most biotechs know the risks to public shareholders, and yet they proceed with PIPEs and other types of private placements anyway, in the belief that their scientific breakthroughs will one day create shareholder value. Consider Novavax Inc. of Malvern, Pa. On Mar. 21, it sold $38 million worth of stock at a 12% discount to 15 investors, most of which were hedge funds, to finance the company's development of an avian flu vaccine. Two days later, the stock tanked 12%, to a level just a penny below the discount price offered to the investors, before gaining back 3% by Mar. 28. Rahul Singhvi, Novavax' CEO, says he doesn't know why the share price fluctuated so. "We had to get money," says Singhvi. "We have such good prospects for the avian flu vaccine. As long as we have financial resources and we can do what we say we can do, the stock will ultimately do well." Hedge funds, he says, "are a necessary evil."

But are they so evil? Some experts argue that hedge funds are the perfect white knights for biotechs, whose financial prospects are so unpredictable. Clinical trials fail. Investor anger grows. Executives seek more money for research and development. Accusations are traded back and forth. "[Biotech] lends itself to speculation," says Michael M. Membrado, a New York attorney who advises early-stage companies on private placements. "The funds in private placements are in the business of speculation and do well in that arena."

The allure of hedge fund money is so strong that it seems to be enticing many biotech companies to go public earlier than they otherwise might, experts say. Some small startups that can't attract enough investment banking interest to pull off an initial public offering are even merging into shells of failed public companies to raise funds. "This is a big trend that we haven't seen before," says Alan G. Walton, a general partner at Boston-based VC firm Oxford Bioscience Partners. He estimates that 40 biotechs will reverse-merge into shell companies in 2006, up from 28 in 2005, and that 90% of the money raised in this fashion comes from hedge funds.

TENSION Chiron CEO Pien is under fire from hedge fund ValueAct Capital

They're Off

Biotech firms are rushing to go public through so-called reverse mergers to get financing from hedge funds.

YEAR	NUMBER OF FIRMS
2006*	40
2005	28
2004	20
2003	21
2002	21
2001	12
2000	6

*Estimate **Data:** Oxford Bioscience Partners

Given the risks they're assuming, some hedge funds say their occasional decisions to sell a biotech company's stock right after they have helped it to raise money makes financial sense. "You get into situations where a stock hasn't gone up, or has gone slightly down, and a company comes back and says, 'I need more money,'" says Mark A. Angelo, founder and president of hedge fund Cornell Capital Partners in Jersey City. "So you say, 'I'll give you the money, but I'm going to sell what I already have because I don't have endless amounts of capital.'"

DEBATABLE DEALS

BIOTECH CEOS UNDERSTAND this reality. In fact, some aren't even worried about short-selling. "I can't lose sleep over people shorting my company's stock," says Vijay B. Samant, CEO of San Diego-based biopharmaceutical company Vical Inc., which raised $22.6 million through a private placement last October. "I just think of how I can keep my program growing and creating news. Shorting the company's is irrelevant."

Other CEOs are even signing deals that could end up giving funds big chunks of their compa their share prices plummet. La stem cell researcher and develop vanced Cell Technology Inc. raise million by agreeing to sell to inve convertibl security th Alameda (company have to back in or cash in the next three years [deal] in some circles would be cons toxic," admits CEO William M. C IV. But "we have confidence in wha doing. It was a lot of incentive vestors to come into [what] in our a developing-stage company."

Still, plenty of CEOs see hedge as a nuisance. Chiron clearly is thused about its dealings with Va Capital. And Ontario-based Corp. has filed suit against a re company it alleges works in conju with short-selling funds to drive prices down. shareholders on M filed a class action.

Even biotech Genentech Inc. i Francisco, which proven products strong revenues, i of hedge funds Arthur D. Levins his cool when a fund manager intent on shaking company's recen long meeting ir York for investo Wall Street a Thanks in large part to its bloc colon cancer drug Avastin, Gene stock has been soaring. But d question-and-answer sessio hedge fund manager, Howard of Flinker & Co. in New York, physician acquaintance "hear deaths from Avastin are highe what recent publicity says." L shot back: "Are you with a fund?" Flinker answered yes.

But he pointed out that he even own Genentech shares. S was Flinker doing at the meetin first place? He declined to comm

–With Susan Zegel in N

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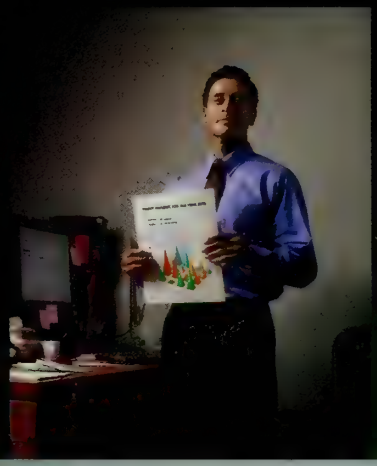

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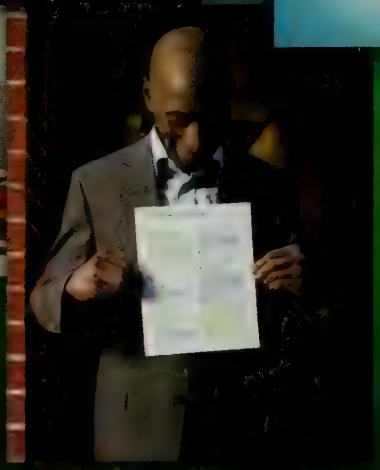

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Dawn of The Idea Czar

When the 'I' in CIO is for innovation, the post should go to a jack-of-all-trades

BY JENA McGREGOR

BILLY EDWARDS' COLleagues at Advanced Micro Devices Inc. have called him their utility infielder. AMD's human resources chief Kevin Lyman calls him the chipmaker's *agent provocateur*. Officially, though, Edwards is called AMD's chief innovation officer, a newly created role for this senior vice-president.

Although Edwards, 50, has a PhD in materials science engineering and has worked around semiconductors for much of his career, he has also headed up strategy at the Sunnyvale (Calif.) company, run a startup, and worked as a consultant for The Boston Consulting Group. So when AMD formalized a role that would lead its innovation effort last September (or, as Lyman describes it, "put an 'X' on the back of someone to consciously drive it"), Edwards' diverse experience, gregarious personality, and penchant for disrupting traditional ways of thinking fit the bill. "A chief innovation officer needs to be this blend of marketer, technologist, strategist, and business person," says Lyman.

In other words, Edwards' new role goes far beyond dreaming up the next chip iteration for AMD. Rather, he'll be spearheading audacious projects that don't neatly fit into any of the company's current functions. One such example is AMD's 50 x 15 initiative, with its goal of getting Internet access to 50% of the world's population by 2015. He's also experimenting with ways to teach AMD engineers to imagine a wide range of scenarios, in an effort to reframe what he calls their "mental maps." And he's sponsoring contests for students to design technology solutions for the world's low-income populations, a vast and potentially huge future market for the company. "When people think about innovation, they think about inspiration, which is a little single-dimensional," says Edwards. "The most powerful [innovations] cross a lot of boundaries."

> Part marketer, part techie, the CIO must have the CEO's ear

NEW HYBRID

A THIRST FOR INTERNAL growth across Corporate America has made innovation a critical management mandate. As a result, the initials "CIO" have increasingly begun to refer not to chief information officers but to yet another C-suite label, the chief innovation officer. That and similar titles, such as vice-president of innovation, are popping up in companies from Citigroup to Coca-Cola to health insurer Humana. Titles of this magnitude send a clear message to the organization: Innovation is an urgent priority and someone should be accountable for it. Most of the large executive search firms are reporting a dramatic uptick in requests for such people. Heidrick & Struggles International Inc.'s Jane M. Stevenson, who heads the firm's global search practice for chief marketing officers, says she has seen a fourfold increase in these positions in the last three years, with most of that growth coming in the last 18 m

While companies have long h level scientists running research a velopment, or marketers steerin product development, these inno chiefs are a new hybrid breed. don't directly report to the chief exe they typically have direct access a Edwards, their jobs are more broa fined. As companies continue to fig just what innovation is, ma charged with running it have see responsibilities evolve. Rather th compass only new products, inno has come to include everything fro ing new business models and fres to glean customer insights, to sha more creative corporate culture.

The structure of the role varies Some CIOs have sizable teams wh ers are more like internal consultan the job may be most closely tied to gy, marketing, or R&D. Tierney Re managing director with executive firm Korn/Ferry International, sa of the innovation officer-led tea seen have started small and grov time as the responsibilities of t have expanded.

That's the case at Humana,

l its chief medical officer, Dr. an T. Lord, to the newly created f chief innovation officer in 2001. ly, Lord's approximately 15-person vas formed to find new innovations mana's core insurance products. s a smaller team, a smaller scope, narrower agenda," says Lord.

over time, Lord's team, which is l on the company's "Innovation" floor in its Louisville headquar- as itself become a corporate function. The team has swelled to 150 employees, many of whom Lord has recruited from places like General Electric Co., Procter & Gamble Co., and the defense industry, with an eye toward bringing in outsiders' perspective and expertise. Lord now keeps a hodgepodge of corporate initiatives under his umbrella. Among them: ethnographic consumer research, external partnerships, and, beginning last year, mergers and acquisitions.

As Humana shows, there seems to be a place for innovation czars at companies of all stripes, but they are particularly hot in the food and consumer-goods industries. P&G, Kellogg, Hershey, Wm. Wrigley Jr., and Newell Rubbermaid have all added high-ranking innovation execs to their lineups in recent years. A CIO role is also becoming more common in mature companies looking for a boost to their revenues. "Companies that are still emerging through rapid growth tend not to need a separate [CIO] because most often the CEO is still the chief innovation officer," says Heidrick's Stevenson. "It's the more mature companies where perhaps [innovation] no longer remains the focus."

"SILVER-TONGUED"

ACCORDING TO HEADHUNTERS, candidates with marketing backgrounds are filling more of the newly created CIO positions. Although some level of technical knowhow—or a lot, at a tech company such as AMD—confers credibility in this cross-functional gig, CIOs have to be able to sell high-risk new ventures throughout often-skeptical corporate fiefdoms. "Marketers are typically pretty silver-tongued," says Greg Welch, who heads up the marketing officer practice for executive search firm Spencer Stuart. "They know how to whisper 'this is our initiative' to the CEO and [win support] more so than some 20-year R&D person."

Whether the CIO is a battle-tested company vet or a fresh-thinking outsider, idea generators with little experience implementing them aren't right for the role. That's one reason why Yankee Candle Co. chose veteran brand manager Rick R. Ruffolo when it expanded its chief marketing officer role to link R&D, brand strategy, and marketing. Before arriving at Yankee Candle in September, Ruffolo had launched new product lines for Limited Brands' Bath & Body Works and managed brands at S.C. Johnson & Son and P&G. Now the product development and marketing departments report through Ruffolo, whose business card reads senior vice-president of brand, marketing, and innovation.

If that title's a mouthful, consider the multifarious duties that confront Ruffolo: establishing a more disciplined way to evaluate and execute ideas, meeting with operations about innovative manufacturing processes, and scouting global markets for new devices to deliver Yankee Candle's fragrances. "If it was just a purely innovation role, I might just run after all these different gadgets," says Ruffolo. "But by linking it to a senior management role, it's not innovation for the sake of innovation."

For Ruffolo, the chief innovation post meant a higher level of seniority; for Lord, becoming a CIO was largely an expansion of his responsibilities. Still, the CIO job is hardly an established rung on the standard-issue corporate ladder—and the risk of failure is high. But able candidates are drawn by the position's high visibility and the rewards that could accompany any successes. "If they're incubating truly new businesses, they could ultimately go run [one of them]," says Spencer Stuart consultant Cathy Anterasian. "That's very exciting." ■

–With Amy Barrett in Philadelphia

PLAYBOOK: BEST-PRACTICE IDEAS

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to make chief innovation officers effective:

FOR TRACK RDS Don't be ted by prolific generators with story of execution. ing how to ment new products cesses and how to ate an organization rs more.

HIRE PERSUASIVE PEOPLE Many CIOs will have direct reports that are in different functions, such as marketing or operations. Rallying those folks to the innovation cause is essential for success.

GIVE THEM ACCESS CIOs will falter without true top-level support, especially if culture change is part of the job. "There are just very few people who can drive that without the ear of the CEO," says Heidrick's Stevenson.

USE DIFFERENT YARDSTICKS Innovation officers won't gain credibility unless they show results. But they'll need extended time frames, cooperation, and more tolerance for failed experiments.

CARVE OUT SPACE Humana transformed a floor of its headquarters for its innovation team. Managers come and go, but changing the actual space of the office sends a clear signal of importance.

SHORE AND PREVOR At their 134 stores, casual duds go for $7.98 or less

Steve & Barry's Rules the Mall

The fast-growing clothing chain manages to underprice even Wal-Mart

BY ROBERT BERNER

STEVEN SHORE AND BARRY Prevor love to fill a void—about 3.5 million square feet of it. That's how much space Steve & Barry's University Sportswear took in U.S. shopping centers last year, the most of any mall-based chain.

The co-CEOs soaked up that space by opening 62 supermarket-size stores, almost doubling their outlets in one year, to 134. The privately held chain, which lures shoppers with casual clothing priced at $7.98 or less—a 40% discount to prices at Wal-Mart Stores Inc. and Target Corp.—plans to operate more than 200 stores by yearend. The key to the rapid growth: a highly opportunistic business model that relies on aggressive incentives from mall owners, creative apparel sourcing, and virtually no advertising. "They are the most talked-about retailer in the mall industry," says Norman Peters, senior vice-president for real estate at Cafaro Co., a Youngstown (Ohio) mall owner. "They're on everyone's list [of preferred tenants]."

Steve and Barry, both 42, opened their first store near Philadelphia's University of Pennsylvania in 1985, while Prevor was getting an undergraduate degree at its Wharton School. The childhood friends sold university-logoed sportswear at prices that easily undercut the expensive gear at college bookstores, doing so well that they opened stores in a handful of other university towns and then in malls. The chain, based in Port Washington, N.Y., now offers humorous T-shirts and an increasing amount of basic clothing for men, women, and kids, such as jeans, cargo pants, woven shirts, and jackets. What really draws shoppers, though, is decent quality at such low prices. "Nothing beats $7.98 except free," says Florence Luka, 37, flipping through racks of shirts at a Steve & Barry's in West Dundee, Ill.

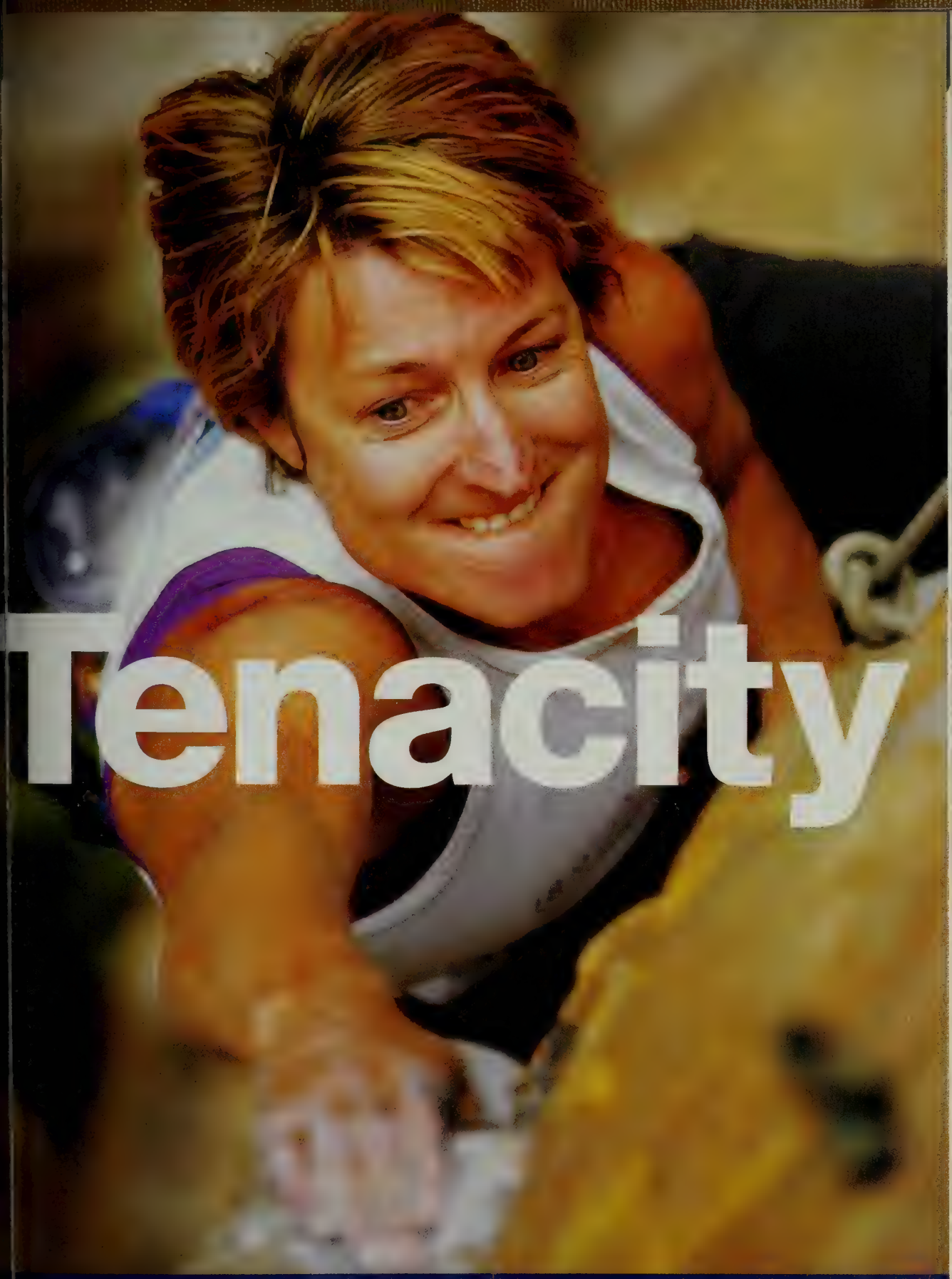
How can Steve & Barry's charge so little? One reason: the cut-rate deals it negotiates with landlords. Most of its stores are in middle-r malls, which seen rising cies, due to t sure of region counters, department store consolic and loss of business to powerful o retailers. "Some of these [mall owne desperate," says Deutsche Bank real analyst Louis Taylor. So as the chain ularity has risen and store size h creased, it has been able to negotiat rates that are less than half those o mall tenants, says Prevor.

SAVVY PURCHASING

LOW RENTS ARE HARDLY the on the men keep costs low. While mal ally give new tenants allowances of $30 a square foot to build interio popularity of Steve & Barry's has a the chain to command "build-out" high as $80, considerably more tha al costs, says Ivan L. Friedman of Consulting Services Inc., which adv tailers on real estate issues. That's e to cover a store's initial inventory, lo operational costs further, he adds. denies that mall payments exceed interior costs. Even so, he says, the question the fees "fuel our growth."

Steve & Barry's also saves money chasing. It buys direct from overse tories, like many others, but cuts c accepting longer lead times. It als by offering steady production thro the year rather than seasonal ram The chain cuts expenses further navigation of import quotas and says Prevor, who can rattle off suc the way a tax lawyer does the Intern enue Service code. That's why it buy from factories in Africa and less fro na than many rivals—most Africa tries face neither U.S. quotas nor Advertising isn't an expense Steve ry's wrestles with, either—it relies on word of mouth. Salaries are n and a third of its 220-person hea ters staff are recent college grads.

Can Steve & Barry's retain its edg vor says he wants to maintain the compounded sales growth rate o aiming for 568 stores by 2008. (Th is profitable, he says, but he won't g ures.) Leaving aside the operation lenges, Marshall Cohen, chief retail for researcher NPD Groups Inc., no the company's model is easy to cop Wal-Mart and Target could ma prices on key items. A Steve & stumble, though, would make ma owners unhappy. Especially the on are helping to bankroll its growth.



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Twilight Of the UAW

The pressure to make wage and benefit concessions won't go away

ON THE LINE UAW Presid Gettelfinger (left) is han tough, but a face-off is c

BY DAVID WELCH

FOR MORE THAN TWO decades, the United Auto Workers has grudgingly allowed Detroit carmakers to slash jobs as they have struggled to keep pace with the onslaught from foreign rivals. That's what UAW President Ron Gettelfinger agreed to when he signed off on General Motors Corp.'s buyout of more than 40,000 jobs at the No. 1 carmaker and its former parts unit, bankrupt Delphi Corp. Where the union has always drawn the line is on bedrock issues: wages and benefits for workers and retirees.

This time, though, that line won't hold. GM's buyouts are the beginning, not the end, of the concessions the union will have to make over the next few years. Unless GM and Ford Motor Co. see miraculous sales rebounds, the UAW at last will have to give ground on pay and health care. Already, Delphi's tough-talking chairman, Robert S. "Steve" Miller Jr., has issued an ultimatum requiring pay cuts of nearly 40% for the remaining 12,000 Delphi workers who can't take GM's offer. If the union continues to refuse, Miller could impose a harsher labor deal in bankruptcy court.

Gettelfinger can't look for relief across town, either. Ford has already announced plans to slash 25,000 jobs and will likely do a buyout deal, too. Similarly, bankrupt auto parts makers—including Collins & Aikman, Dana, and Tower Automotive—are using the courts to cut pay or close factories. Says a high-level official at another union: "This is a leadership moment for the UAW. We've had to deal with this in steel and airlines; now it's autos' turn."

What's going on is nothing less than the slow death of what was once the country's most powerful industrial union. Despite years of relentless global pressure, the UAW has been able to maintain some of the best blue-collar posts in the U.S. But like lumbering GM itself, the union failed to realize what it would take to compete in a world economy. In the 1980s and 1990s, it fought concessions that would have helped U.S. carmakers fend off imports. The upshot: Like GM and Ford, it's paying the price today.

This year alone, the UAW will lose about 70,000 of its 640,000 members as a result of cuts at Ford, GM, and Delphi, bringing total membership to well under 600,000, vs. 1.5 million in 1980. At the same time, wages at parts makers are plunging and the paid-layoff clause, known in Detroit as the JOBS bank, is certain to be vulnerable when Big Three executives and UAW leaders face off in bargaining next year. Add it all up, and "this is the decline of the UAW," says Sean McAlinden, chief economist with the Center for Automotive Research in Ann Arbor, Mich. "We're in the 21st century. It's over."

The UAW's setbacks highlight a broader challenge faced by blue-collar America. Just as union bargaining muscle helped make the middle class, so too does its weakening signal the stiffer barriers less-skilled workers face in globalized economy. Ju of households head someone with only school degree are middl in 2003, vs. 68% in 19 cording to the National on Education & the Ec in Washington. "There opportunities for those out higher education they're shrinking every year," says Senior Fellow Anthony Carnevale.

BRINGING IN BUYOUTS

UAW LEADERS bristle at the thoug they are losing clout. Gettelfing *BusinessWeek* in an interview last y "every Labor Day there are stories that we're going away. But we here." True, he does still wield t dous power over the Big Three. H tiated buyouts of $35,000 to $1 from GM rather than pink slips fo ers. GM will fund the estimated $4 to $5 billion in total restructurin for its plants and those of Delphi

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ing off parts of its General Motors Acceptance Corp. finance arm and its stakes in Japanese auto companies, which is what Gettelfinger really wanted. And so far, the cuts to health-care benefits still leave his retirees with a better medical deal than most employees have. Nor have hourly workers yet lost ground in health care.

But the UAW's grip on wages and benefits can't last. America's employer-paid medical insurance amounts to an ever-increasing tax on domestic manufacturers trying to compete with foreign rivals based in countries with nationalized health care. Meanwhile, foreign auto makers get state and local tax breaks to build new plants in the U.S. that in some cases amount to five years' worth of their wage bill, says AlixPartners LLC Managing Director John Hoffecker.

CHINESE AUTOS ON THE WAY

THERE'S ANOTHER buzzsaw coming: cars from China. Every big auto maker is expanding production in the Chinese market, and analysts expect most to start exporting vehicles to the U.S. in a few years. "Chinese cars are coming," says Harvard University economics professor Richard Freeman. "I don't know if the UAW can hold on to its wages and benefits [in the face of that]."

The UAW's prospects look eerily similar to those that once faced another old-line union, the United Steelworkers. In 2002, after decades of relentless battering from global rivals, most U.S. steelmakers were hopelessly uncompetitive. To salvage what was left of the industry, the Steelworkers agreed to cut wages and benefits as well as jobs.

Most dramatically, the union allowed players such as U.S. Steel Corp. and Bethlehem Steel Corp.—then headed by none other than Delphi's Miller—to all but wipe out their legacy costs. The companies ended retiree health plans and used bankruptcy court to dump pension plans onto the federal government, cleaning billions off their books and out of steelworker retirees' pockets.

The UAW appears to be headed down the same path. "We were told by our union that we can expect to see a very different Delphi," says Skip Dziedzic, shop committee chairman of UAW Local 1868 near Milwaukee. "And I think we will." UAW workers can also expect to see a very different auto industry, and because their fortunes are so intertwined, a vastly diminished union. ■

–With Aaron Bernstein in Washington

Way Beyond Home Videos

YouTube could be a new NBC–or another Napster

BY HEATHER GREEN

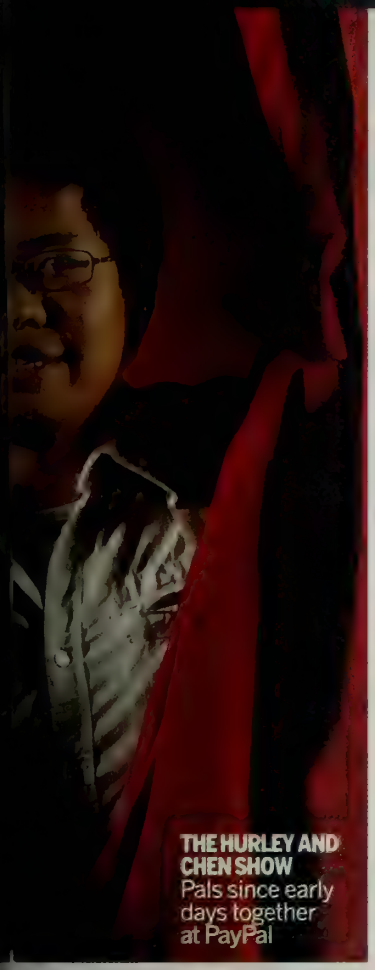
ALL CHAD HURLEY AND Steve Chen wanted to do was share some videos from a dinner party with a half-dozen friends in San Francisco. It was January, 2005, and they couldn't figure out a good solution. Sending the clips around by e-mail was a bust: The e-mails kept getting rejected because they were so big. Posting the videos online was a headache, too. So last February the two buddies got to work in Hurley's garage, determined to design something simpler.

What they came up with is a Web site, now called YouTube, that has become an Internet phenomenon. In 11 months the site has become one of the most popular on the Net. It shows 30 million videos a day and drew 9.1 million people in February, says Web measurement service Nielsen//NetRatings. That makes the upstart one of the biggest providers of videos on the Net, ahead of Yahoo! and Google and just behind Microsoft, according to the Nielsen//NetRatings estimates.

Why has the site caught on so fast? Chen and Hurley designed it so people can post almost anything they YouTube in minutes. The result is thing like the TV station you dreamed of. YouTube offers main shows from the current season from TV's earliest days, and hom movies from around the worl watch what you want when you whether it's highlights from Los A Laker Kobe Bryant's 81-point outl January or a 1968 clip of Johnn performing *Ring of Fire*. Membe can comment on videos and set u own sites on YouTube, are 30,000 new videos a day. "Fro One we concentrated on building ice and community around video Chen. "That made us a lot differe the iTunes and the Googles out th

TOO OPEN?

THE TROUBLE IS, THE freewhee proach that has made YouTub could be its downfall. Users ha posting videos that are still unde right, without any of the require approvals. These include clips fr Olympics, prime-time news episodes of *The Office*, and music Needless to say, this doesn't sit w



THE HURLEY AND CHEN SHOW Pals since early days together at PayPal

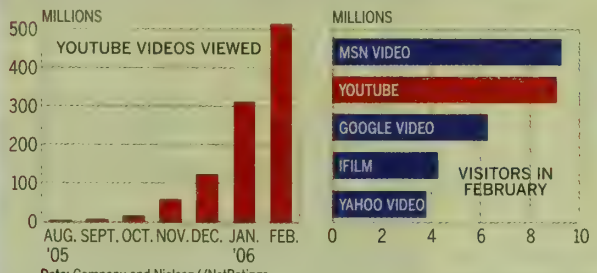
ajor media companies. NBC, CBS, hers have requested that YouTube e clips taken from them. Hurley hen typically don't screen out copy- d works before they're posted, but o comply with all such requests.

t raises the question: What does be want to be when it grows up? Is ext NBC or the next Napster? Hur- d Chen think they're working to- he future of TV. Venture stalwart a Capital is betting on the ct, having invested $3.5 million. eptics wonder if the startup can e its surging popularity with the g legal risks. "I think YouTube is ic," says Joanne Bradford, head of MSN and other Microsoft proper- But five years from now I don't ow they make their money. Their n is all the pirated content."

next few months will be critical. and Chen are investigating r they can generate revenues by advertising. They're also working vince media companies that e can be a good partner, capable ering an audience of millions. The teo (Calif.) company is rolling out imed at protecting copyrighted works, including technology that prevents clips from being uploaded again once they've been removed. They're also limiting videos to 10 minutes to cut out entire TV episodes and movies. "We want to be a destination that promotes the entertainment offered by these guys," says Hurley, YouTube's chief executive.

YOUTUBE'S LIFTOFF

YouTube is rocketing to popularity through a mix of community features, homemade videos, and copyrighted works



Data: Company and Nielsen//NetRatings

Some major players are showing interest. Marketers for Nike Inc. used the site to run a spot of soccer star Ronaldinho showing off with a new pair of Nike shoes. Satellite TV service BSkyB, which distributes *The Simpsons*, posted a live-action version of the animated show's famous intro to promote it in Britain. And Matador Records is marketing several bands on YouTube with specially created video contests and biographical clips. "We love the Tube," says Adam Farrell, Matador's online marketer. "Their numbers are undeniable."

Hurley, 29, and Chen, 27, feel at home in turbulent times. They got their start in the business world during the dot-com bubble and the bust that followed. They were among the first 20 hires at online payment service PayPal Inc., joining during the second half of 1999. They got to know each other well during the lean years, becoming part of a tight-knit PayPal mafia that remains close today. Their venture money came in part through their connection to Roelof Botha, a Sequoia Capital partner who had been PayPal's CFO.

A key lesson Hurley and Chen learned from the PayPal days is flexibility. PayPal's founders started out providing security software for handhelds and then tried several other fields. Only later did they hit on the idea for their online payment system, a business that eventually was sold to eBay Inc. for $1.5 billion in 2002.

Hurley had an entrepreneurial streak from the start. He grew up in the Philadelphia suburbs and as a 5-year-old tried to sell paintings from his front yard. He studied design at Indiana University of Pennsylvania and landed at PayPal after reading about it in *Wired* magazine and sending an e-mail inquiry about a job. During his interview he designed a new logo for PayPal, one that executives liked so much they still use it today. He left after the eBay deal, working with a few companies as a design consultant.

ELUSIVE BALANCE

CHEN, YOUTUBE'S chief technology officer, has been a math and science geek since high school. He threw himself into programming and computers at Illinois Mathematics & Science Academy and went on to study computer science at the University of Illinois at Urbana-Champaign. During his last semester he was recruited by Max Levchin, cofounder of PayPal and a former classmate. Chen remained at PayPal until early last year to help finish launching the company's expansion into China.

ANYTHING GOES YouTube viewers can post clips of *Scary Movie 4*, Johnny Cash in concert, and *Wayne's World*

In the year since, Chen and Hurley have come a long way. Yet they are still searching for the right balance to turn their sudden popularity into profits. If they cater too much to their users, they risk getting sued for copyright violations and losing the support of content companies. If they're seen as favoring content companies, however, they could lose their millions of fans. It's a challenge they couldn't have imagined a year ago. "We started this to solve a personal problem," says Hurley. "Now we're creating a new way to reach audiences in an era where the traditional TV time slot doesn't exist anymore." ■

An Open-Source Lightning Rod

Marc Fleury has taken JBoss to the to but he has alienated many along the w

BY SARAH LACY

ONE WEEKEND BACK IN December, Marc Fleury was hunched over his computer, absorbed in writing a fervent, almost preachy and completely self-serving blog about why IBM and BEA Systems Inc. will never be able to best his tiny but growing open-source company, JBoss Inc. His 6-year-old daughter walked up to him and asked: "Daddy, why are you still working on a Sunday? Is IBM still after you?" He laughed and replied: "Yes, darling...but now a whole industry is ganging up on us."

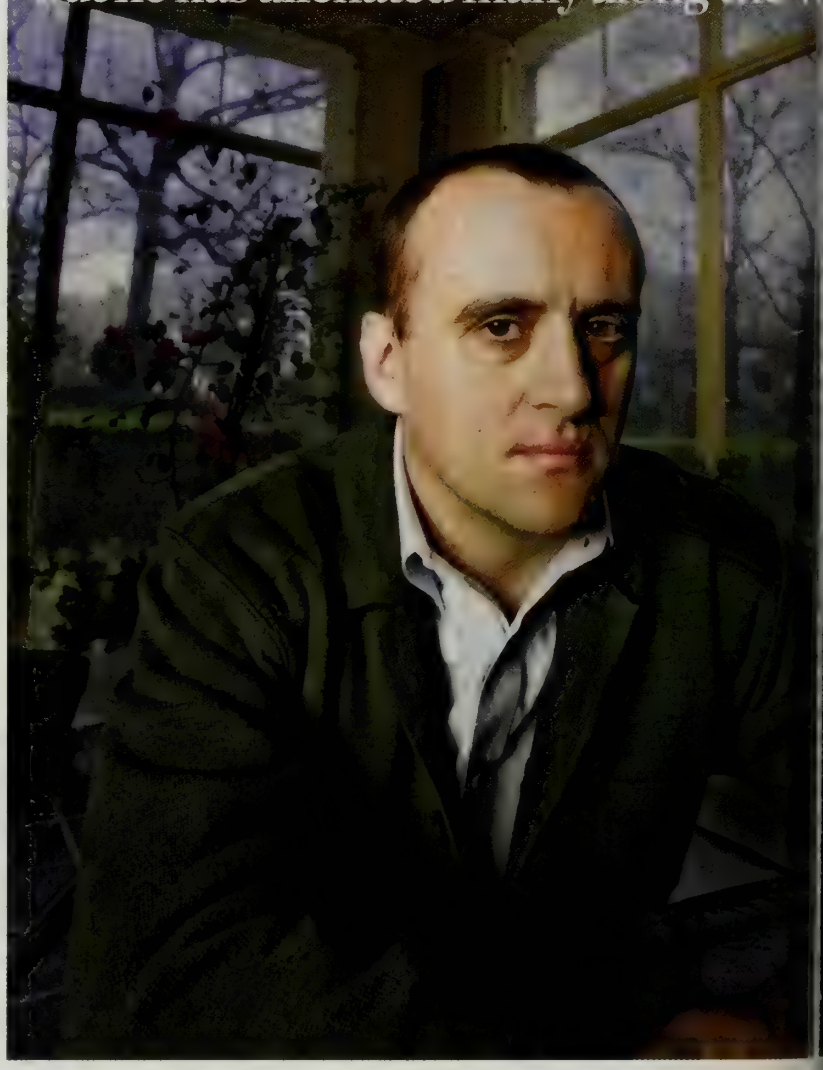
That's life in the Fleury household. The entrepreneur's favorite movie is *The Matrix* because, like its protagonist, Neo, he has long fancied himself working a boring day job and then saving the world at night. Fleury's company, JBoss, is a key player in the booming open-source movement that's shaking up every software company from Microsoft to Oracle to IBM, forcing them all to change their strategies or to collaborate with younger, faster-moving competitors that develop "open" software, distribute it freely on the Net, and make money by providing support and training for it. When JBoss took in venture capital in 2004, it was valued at $200 million, and those close to the company say Fleury and his family own nearly 50%.

PROFIT MOTIVE

BUT WHILE FLEURY, like Neo, is something of a cult figure, few people in the old or new software world want to think of him as their savior. Brash, outspoken, and frequently insulting, Fleury has clawed his way to the top of the open-source pile over the past six years. Part of the dislike arises because he's a threat. Even though JBoss brings in only $50 million a year in revenues, at most, from providing training, support, and maintenance services to its users, it has siphoned off some hundreds of millions in market value from the likes of BEA Systems and IBM by giving away free software.

Meanwhile, some open-source companies are put off by what they say is Fleury's money-grubbing, controlling style. It's out of keeping, they say, with the cooperative, do-it-for-the-greater-good ethos of the open-source movement. Stuart F. Cohen, head of Open Source Development Labs Inc. (OSDL), a nonprofit group that advocates for the development of Linux, the open-source operating system, remembers the first time he met Fleury. He had been invited to Atlanta to be on a panel at a JBoss customer event, and Fleury kept asking when he was going to take OSDL public. "To him, everyone is out to make money," he says. "That's not what this idea is really all about." Even competitors from the traditional software world criticize Fleury for having what they say is a cynical profit motive. "Marc Fleury has really exploited the open-source hype for his own personal financial gain," says one. Fleury's reply: "That's like someone telling the rapper 50 Cent he's not street enough."

If Fleury is focused on making money, perhaps that's because he spent a few frustrating years in Silicon Valley making none. His ambitions were nearly crushed in 200 he and his wife, Nathalie, an young daughter left Silicon Valley less after he had spent years tr build a software hosting compan Telkel. He was disillusioned and playing the Silicon Valley game:



FLEURY at his ir Atlanta home, he lived during dot-com bust early startup f

er a business plan and shopping it l to "snooty" venture capitalists. ıe moved into his in-laws' house in a and focused on contributing to an ource project that he and others arted in 1999, JBoss. All he wanted he told his wife, was write code for l day long. "She told me I was stu- ıe says, and gave him a year to $70,000 or else get a job. Then nies downloading JBoss software l asking him for training and sup- and offering to pay. A year later, had made more than $100,000.

NDING PERSONALITY

ORTH A LOT more now, to the dis- f his critics. Some investors have fused to invest in JBoss because of s style. "It's a strength and a weak- says David R. Skok, a partner at and the company's biggest outside r. "Because he's so disliked, it cre- credible controversy and incredible I think he knows that, and kind of hat up." His personality may have a part in what insiders say was an om Oracle Corp. earlier this year l apart. Oracle is said to have val- e small company at nearly $500 —a big endorsement of open that had entrepreneurs and capitalists licking their along with JBoss employees, vn a large chunk of its stock. her Fleury nor Oracle will com- n what happened, but insiders say al died because of Fleury's de- about what his role would be at nbined company. With Oracle pay- h a premium, the deal was going ntegrated its way, not his. Fleury only this: "One of the conditions selling to anyone is we remain and I remain the boss."

ry owns up to the reputation that developed. Sitting in an unkempt in a flashy Atlanta building, he a giant cup of coffee before drib- Visine into red-rimmed eyes. He nflower seeds in a cup as he talks why people hate him. The old soft- world? They're jealous. Open- zealots? "They probably hate me t because they didn't have the *co-* go out and do [what I've done]." ourse, no one says you have to be a y to make it in software—just ask who have worked for Microsoft's es or Oracle's Lawrence J. Ellison, Fleury names as personal heroes. hough Fleury didn't write the most parts of JBoss code and wasn't the ine-tune the business model, JBoss probably wouldn't be where it is without him. As much as he is despised outside the company, its executives and developers describe him as the visionary who holds JBoss together. "The public face of Marc is very abrasive, but inside the company, he really cares a lot about what you have to say," says Sacha Labourey, JBoss's chief technology officer and one of its first employees.

> "Inside the company, he really cares a lot about what you have to say"

Fleury has hired some of the best contributors to the open-source project, who work for him remotely from around the world. He fancies himself a sort of record label managing "rock stars." He has always wanted to be a hotshot programmer himself. During his first tech job at Sun Microsystems Inc. in France, the company kept trying to push him into sales or middle management, and he insisted on software development. When he came to Silicon Valley with Sun in 1997, he continued to be frustrated when he couldn't break into its elite programming teams.

Now, as an employer of elite programmers, he gives them the freedom to take months on projects of their choosing. He rewards them with "genius grants" when they do something particularly innovative. "Managing superstars is one of the things I can do," he says. As Fleury talked to *BusinessWeek*, he was planning a surprise birthday bash for one of his "geniuses." The details: "We are going to get this horrible stretch limo and go out to dinner and [the clubs]."

A few weeks ago, Fleury's daughter had another question for him: "Daddy, is JBoss still going to be around when I'm big?" She's not the only one wondering about that. Red Hat, Novell, and Oracle are all said to be interested in the company. But quietly, several industry watchers say the cocksure Fleury blew his chance. Aside from Red Hat, there are few businesses that have proved they can scale up using the free-software model. Red Hat's steep earnings multiple, which tops 80, along with the $500 million that venture capitalists pumped into startups last year have some worried about an open-source bubble that may be nearing its limit.

If Fleury is kicking himself, he's certainly not doing it publicly. He and his investors say they're focused on getting ready for an initial public offering, which will come "sooner rather than later," according to Chief Operating Officer Rob Bearden. "They'll be rich," Fleury boldly says of investors and employees. "I'll create a generation of open-source millionaires, and I'm damn proud of that." ■

–With Brian Grow in Atlanta

BIO

Marc Fleury

Brash and outspoken, he sees himself as one of the good guys

BORN Nov. 22, 1968, Paris.

CAREER Began tech career in sales at Sun Microsystems in France before moving to Silicon Valley in 1997 to work for Sun as a programmer. Started the JBoss project in 1999, along with a software hosting startup called Telkel that ultimately failed. Moved to Atlanta in 2001 to pursue JBoss.

INDUSTRY HEROES Bill Gates, Larry Ellison, and Linus Torvalds.

EDUCATION BS in mathematics, Ecole Polytechnique in Paris, 1991; masters in theoretical physics, Ecole Normale in Paris, 1992; PhD in physics, Ecole Polytechnique, 1996, for work done as a visiting scientist at Massachusetts Institute of Technology.

FAMILY Wife, Nathalie, a six-year-old daughter, and twin three-year-old boys.

FAVORITE FLICK *The Matrix*, hands down. "As corny as it is, I totally identify with Neo: boring job at day, and at night I save the world. And what's not to like about Trinity?" he says, describing the film's female lead and making a purring noise.

HOBBIES Skiing, PlayStation, techno music, learning to figure skate with his daughter.

BusinessWeek online For a Q&A with Marc Fleury, go to www.businessweek.com

Is housing set to blow, or are there more gains ahea Here's how to navigate an anxious market. BY PETER C

Confused about the direction of the housing market? It's no wonder. hear stories about sellers slashing listing prices to attract buyers, but h prices nationally have risen more than 10% over the past year. Inventori unsold homes are on the rise, yet homebuilder Lennar Corp. just report 34% jump in earnings. And the much feared rise in 30-year mortgage r seems to have stalled. ¶ In this muddled situation, what should you whether you're on the buyer's end of the seesaw or the seller's? Cut your p now or hold out for more? Rent or buy? Go for a bigger house or a sma one? In the New York City suburb of Larchmont, N.Y., where prices a off their peaks, confusion reigns. Says Realtor Carol Higgins: "Buyers are complaining that prices are astronomical, but sellers are still thinking they'll get what they saw their neighbors get last year." ¶ Let's be honest: No one can predict with certainty which way home prices will go in the next year or so. Over the past several years almost everyone who has tried to forecast the direction of the housing market has been wrong (though *BusinessWeek* Chief Economist Michael Mandel takes a shot on page 76). ¶ We can, however, tell you how to avoid some critical psychological and financial mistakes in today's anxious markets. No matter how smart you are, it's easy to fall into certain mental traps that can cost big bucks. Instead of concentrating on the fundamentals, people tend to be ruled by their feelings and the compulsion to compare themselves with their neighbors. If your brother-in-law made a killing in real estate, you're determined to do the same. "So much of what drives the housing market is human interpersonal dynamics," says Yale University economist Robert J. Shiller. ¶ What follows is

Buyer (and seller) Beware

LIVING IN THE PAS

In a softening market, many sellers find it tough to bite th bullet and cut their asking pr JoAnn Watson and her husba are hanging tough in New Rochelle, N.Y.

a set of practical guidelines for navigating today's choppy and uncertain real estate markets. The suggestions come from behavioral economists, who study the kinds of erroneous decisions people tend to make repeatedly, as well as from hands-on real estate experts. In addition we'll tell you which cities are more vulnerable to a drop in prices and which are less at risk. (Go to businessweek.com for a free interactive table showing how 30 major metro areas stack up on 11 different housing-related measures.)

Contrarian Cool

A FIRST RULE OF THUMB is to avoid herd behavior, which is what lured a lot of people into overpriced houses in the first place. The expectation of rising prices became a self-fulfilling prophecy as office mates and in-laws tried to leapfrog each other. The prevailing mindset: "You see people who aren't particularly talented, who aren't hard-working, who buy a house with nothing down, and they've been getting rich doing it. If they're getting richer, then you're falling behind," says Robert H. Frank, a Cornell University economist and author of *Luxury Fever*. Another attraction of herd behavior is safety in numbers. Millions of buyers can't all be wrong, can they?

Also, behavioral economists have discovered in laboratory experiments another attraction of herd behavior. Misery really does love company: People seem to worry less about losing a lot of money if they think ev around them will suffer the same fate.

Still, the rewards of thinking independently can b Richard X. Bove, a financial services analyst at boutique ment bank Punk, Ziegel & Co., put on his green eyesha concluded that Florida real estate was overpriced. So ear year he bailed out. Bove sold his 5,600-square-foot St. burg (Fla.) home for $1.2 million, twice what he paid decade ago. The plan was to rent while he waited out a h decline. But Bove couldn't find a suitable rental, so he lo a four-bedroom house in Tampa and got it for $740,000 below the asking price.

In a softening real estate market, one of the most dar mental mistakes is what behavioral economists call "los sion," which is the tendency to do dumb things to avoi costs, recording a loss. Some sellers are so averse, they

Take a Hard Look At How You Think

You can make better choices by keeping in mind what behavioral economists have learned about the attitudes that often lead to poor decision-making

HERD BEHAVIOR In frothy markets, prices get out of fundamentals because of speculation and trend-foll

Solution: Before buying, assess what houses are re in the area where you want to live.

LOSS AVERSION People who bought high hate to sel take a loss. Some gamble recklessly that the market rebound and bail them out. That just worsens the pr

Solution: Cut your asking price and make the sale.

OVERCONFIDENCE It's human nature to think you kr you're doing. Reality, however, is often unkind.

Solution: Whether you're a buyer or a seller, make a accounts for worst-case scenarios.

LOOKING BACKWARD Sellers' thinking tends to be s behind the market. So when prices are rising, they s too low, and when prices are falling, they set theirs t

Solution: Assess where the market is headed, not wl

DANIEL BYRNE

OWN MAN

lependent nking has its vards: Richard ve sold high d bought v this year in orida when correctly culated that e market was akening

PRESTON MACK/REDUX

SING TCH

the market will bounce back rather than cut their prices.

Indeed, real estate agents often have a much clearer idea than sellers that demand has softened. "The hardest thing is to convince the sellers of the change in the market," says Alfonsina Rechichi, an agent at Coldwell Banker Residential Brokerage in Katonah, N.Y. "There's a sense of fear among brokers u sense at open houses," says Saul Greenstein, a renter hington, D.C., who suspended his house search because were too high. "The self-confidence you saw a year ago en replaced by fear and pandering."

owners who stand to make a big profit on a sale often price too high. In this case the mental error isn't loss n but outdated thinking. New research shows that sellers set their listing price, in part, based on information six months to nine months old. That means if you don't pay close attention, you will tend to underprice in a rising market and overprice in a falling one.

HINKING Even when renting would be cheaper, many st on ownership because it satisfies a deep-seated curity, as in "a man's home is his castle."

ake the step of at least looking at comparable rental re buying.

P WITH THE JONESES Obsession with status vers to overspend on conspicuous displays—and more conspicuous than your house.

ealistically assess the future costs of ownership, f you have an adjustable-rate mortgage.

TY FALLACY Some homeowners have a false sense ce that property will keep its value better than s like stocks and bonds.

on't put all of your money into real estate.

Stung on Both Ends

TWO SMART PEOPLE WHO JUST MIGHT be guilty of that in the New York City suburbs are Joe Watson, a neurosurgeon, and his wife, JoAnn, who has a PhD in genetics. In relocating from New Rochelle, N.Y., to McLean, Va., they planned to come out even by selling and buying at roughly the same price: $1.2 million. Now they're getting stung on both ends of the transaction. The Virginia house is costing them "significantly more" than $1.2 million, and they can't get what they want for their 1937 Tudor in New Rochelle. Says JoAnn: "We were advised by two brokers to price it initially at $999,999, but my husband and I wanted to start at $1.19 million because we thought we could get it." Even after nudging the price down to $1.09 million, though, there haven't been any offers. JoAnn has taken to blaming the shoppers. "It's a great house," she complains. "Why doesn't anyone realize it?"

The gravest danger of dragging your heels on price cuts in a sinking market is that you can "follow the market down," never managing to sell because your price is always just a little too high, says Christopher J. Mayer, a Columbia Business School economist. He and David Genesove of Hebrew University in Jerusalem found that when prices were falling in Boston in the early 1990s, two-thirds of the houses that came on the market were eventually withdrawn without a sale.

In parts of the country where the market is still strong, a common sin continues to be overconfidence. Owners typically don't seriously consider a wide enough range of potential housing market outcomes, including the possibility of a steep decline. That leads people to take more risks than they should.

Nordstrom Inc. managers Robert J. Gelb, 50, and his wife Cindy, 47, of Mercer Island, Wash., own the house they live in as well as two they bought for their children. Gelb says last

Where Houses Are Affordable...

Housing Opportunity Index* (higher is better)

DETROIT	ATLANTA	DALLAS	HOU
86%	76%	60%	5
Houses are cheap because many people have lost faith in the Motor City's future. Since 2000, employment has fallen 7%, and the number of annual construction permits is off 15%.	Its 28% price increase since 2000 is one of the lowest among major metro areas, according to the federal government. One negative: 41% of mortgages to buy homes last year were interest-only.	It's easy to build in Texas, so prices stay low. Construction permits have risen 37% since 2000 even though job growth has been flat. It's almost as cheap to buy as it is to rent.	Houston's grown faste but so has Houses in b are actually accor Global Insi City Co

* National Association of Home Builders Housing Opportunity Index. This is the percentage of new and existing homes sold in the fourth quarter of 2005 that were affordable

year's appreciation on the house his son occupies was greater than his son's salary at Nordstrom's. For the house they bought for their college-student daughter, they put down 3% and got a negative-amortization loan, which Gelb says makes it a better deal than renting her a dorm room. "Worst case is that I sell it for what I paid for it," he says. His take on housing is nonchalant: "Even if it is a bubble...it would be a slow leak. Maybe some people would say I'm naive, but I don't see a downside."

Optimist Gelb is well-off enough to take a slump in stride. Still, he might want to have a conversation with Linda R. Fink, 57, who manages a city park with a bicycle-racing track in Indianapolis. She knows all about slow leaks. Fink bought a house in November, 2000, for $120,000. At the time, Fink says, she viewed the purchase as an investment and reassured herself that "if something happens five or six years down the road, I'll be O.K. I can sell it and get out."

Instead, Fink watched home prices in her neighborhood fall and fall. She bailed out in 2004 for $92,000 in a "short sale," meaning the lender got the proceeds of the sale but not all it was owed. Says Fink: "It all just blew up on me."

Rent-vs.-buy decisions are a perfect example of what the housing market can learn from behavioral economics. If financial efficiency were all that mattered, more people would be renting nice houses instead of buying them, even taking into a the home mortgage-interest deduction. But there's son comforting about owning the place where you lay your h the pillow each night. "It's worked out so phenomenal," first-time buyer Obrey M. Minor, a 27-year-old special ed teacher who bought his first house last year with his wif Houston suburb of Katy.

You can hear how much homeownership matters by

BOB HOWER/QUADRANT

MEAGER OFFER

You better believe home prices can fa Linda Fink paid $120,00 for a house i Indianapolis 2000. Four years later sh was able to g only $92,00 for it

MIAMI	NEW YORK	SAN DIEGO	LOS ANGELES
14%	**6%**	**4%**	**2%**
House prices in metro Miami rose 128% from 2000 to 2005, in part because of speculation. Loan Performance LLC says a high 17% of homes last year were bought as investments.	New York is chronically expensive, so its low affordability ranking doesn't prove that a crash is imminent. Land controls keep prices high. Issuance of construction permits has fallen 21% since 2000.	Monthly costs to rent a home in San Diego are just 38% of the costs to buy a similar property, according to Torto Wheaton Research. That's an indication that buyers are paying way above true value for houses.	According to the National Association of Home Builders, only 1 in 50 houses sold in L.A. late last year was affordable by a median-income family. Many people stretched to buy houses that are beyond their means.

ian income.

Data: National Association of Home Builders, Torto Wheaton Research, Labor Dept., Loan Performance LLC

le like Annapolis (Md.) renter April McKinley, a health-nsultant who recently moved with her police officer hus-om Pittsburgh to the Washington (D.C.) area and ran into a wall of high prices. "Here I am, a productive citi-d I can't afford to own a piece of it," says McKinley.

cially in upscale communities, social pressure to buy is in-onathan Miller, CEO of real estate appraiser Miller Samuel calls that when he and his family moved to upper-crust Darien, Conn., 15 years ago and rented for a year, "we were absolutely second-class citizens. It was very unpleasant."

Call it "castle thinking"—the notion that a home is a fortress against a cruel world (table). And it's perfectly defensible. But in many markets the total monthly costs of renting are far below the total monthly costs of owning the same property—62% cheaper in San Diego, for example, according to Boston-based Torto Wheaton Research, a unit of property manager CB

MEMBER OF THE CLUB

Jonathan Miller says he and his wife felt like "second-class citizens" when they rented for a year before buying a home in upscale Darien, Conn., 15 years ago. "It was very unpleasant"

RICHARD FREEDA/AURORA

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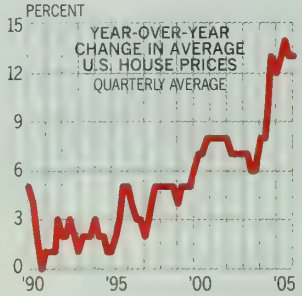
Sun microsystems share

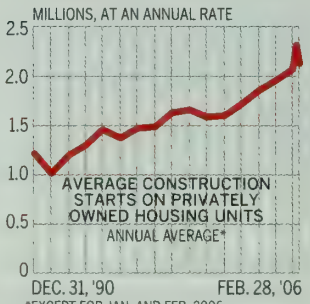
Is the Market Strengthening or Weakening?

Home prices are still rising fast...



Data: Office of Federal Housing Enterprise Oversight

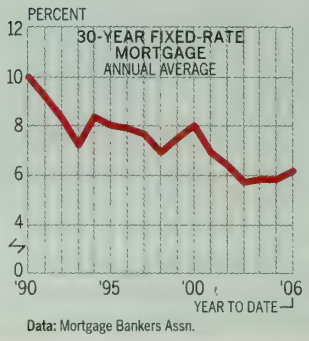
...and plenty of new homes are being started...



*EXCEPT FOR JAN. AND FEB. 2006

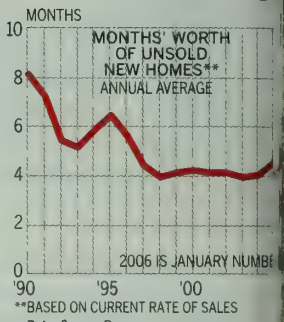
Data: Census Bureau

...but now interest rates are creeping up...



Data: Mortgage Bankers Assn.

...and inventories of unsold homes are rising



**BASED ON CURRENT RATE OF SALES

Data: Census Bureau

Richard Ellis Group Inc. So you owe it to yourself to be aware that your castle thinking can be a costly predilection.

Neuroscientists have even discovered the place in your brain that makes you spend too much on a house. Far from behaving perfectly rationally, real people are pushed and pulled by signals emanating from below the neocortex—the primitive "lizard brain." That may be why there are so many homes with empty marble foyers, faux Roman columns, dust-collecting Jacuzzis, and exotic drooping conifers on the lawn.

Manage Your Cravings

WHAT PEOPLE CAN DO is be aware of their human tendency toward status-seeking. Cornell's Frank suggests channeling the drive more productively. If getting your kids into a good school district is a priority, for example, try to satisfy your lust for status by buying a smallish house in a prime school district instead of a showplace in a worse one. "You have some choice," says Frank. "There's room to do better."

A foible that helps account for America's obsession with real estate is what you might call the tangibility fallacy. It's the all-too-human tendency to regard tangible things like houses as more stable and trustworthy than intangible ones like stocks and bonds. It's true that a house provides more comfort than a book entry in a stockbroking account. But that doesn't mean it's a better investment.

Open the Doors, Look in the Closets

Study Your Local Conditions: This interactive table lets you analyze real estate in 30 metro areas.

Slide Show: What $500,000 buys in each of 12 markets.

An Economist's View: Yale's Robert J. Shiller says there is a housing bubble.

The Story Behind the Story: For a podcast interview with Economics Editor Peter Coy by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.

Hot Property Blog: Our real estate writers weigh in at businessweek.com/the_thread/hotproperty/index.html

Staging Homes for Sale: For tips on how to make your home stand out, including hiring a professional stager, watch *BusinessWeek Weekend*. Check your local TV listings or view it at businessweekweekend.com.

BusinessWeek online

www.businessweek.com/extras

In fact, except for the past few years, house prices hav only 1% or so faster than the rate of inflation. But just try that to Ron DeLucia of Jacksonville, Fla., who at the ag is selling his current home and buying a bigger one town, in part because he and his wife think a house is trustworthy asset than shares of stock. Says DeLucia: went through the crash of the market. I lost $150,000. Y er get that money back. I think the stock market is goin down. I'd rather put the money we have in hard ass property."

And finally, it's easy to lose your head over housing thinking isn't disciplined. To find your moorings, try to f the fundamental factors that determine value. On that s somewhat reassuring to realize that prices in the U.S., high, are not out of line with other major countries. I properties that are exactly comparable is difficult. But in scientific survey, *BusinessWeek* correspondents rounded ings for a few homes for sale around the world. There's bedroom in Kleinmachnow, a pricey suburb of Berlin, g $525,000. In the upscale Golders Green neighborhood don, 20 minutes from the city center, a four-bedroom h on the market for $1.56 million. And in Tokyo's Suginam three bedrooms squeezed into a cozy 987 square feet $566,000. These kinds of prices have a familiar ring.

Reading the Tea Leaves

WITHIN THE U.S., HOWEVER, prices in some housing do raise red flags. A good starting point is to look at the ability of homes for ordinary families. By that measure Los Angeles was the worst in the nation in the fourth qu 2005. Only 2% of homes sold there were affordable by earning the area's median income, according to the N Association of Home Builders. New York wasn't much 6%. Other expensive big cities included San Francisc Miami at 14%, Boston at 24%, and Washington, D.C., Tops in affordability among big cities were places like with 60% of homes sold affordable by median-income f San Antonio and Houston at 57%, and Chicago at 48%

Of course, unaffordability is a chronic condition in ci New York, so it's not necessarily evidence that a sharp tion is in the offing. Economists at Global Insight Inc. tional City Corp. deal with that by looking at whether m eas have departed from their own historical tre affordability. They conclude that in the fourth quarter, the top 299 metro markets were "extremely overvalue

Real Estate Brokers Are Racing for Shelter

TIMOTHY J. MULLANEY

Barbara is a real estate agent in northern Virginia. She won't disclose her full name because she would be fired instantly if her bosses knew what she was g: promising customers discounts on gold-standard 6% commission charged ll-service brokers.

lost real estate companies require ts to get permission to cut a mission, or, like Barbara's employer, ly forbid it. But as the housing market s weaker on both coasts and in regions tween, more and more agents are g to accept lower fees to drum up sales. ara is getting clients from the two- h-old referral service Realty Legacy p. She charges a full commission in all fficial sales documents but later tly rebates at least 1.5% of the house in the form of a personal check to the . That hurts, but it has generated 20 in a few weeks. "Legacy allows you to tiate the commission, but in a discreet she says. "I think it's brilliant."

illiant ploys are essential in today's lly competitive market. After a five- oom, the National Association of ors forecasts a 5.7% decline in existing-home sales this year, to 6.7 million. Inventories of unsold existing homes are up 27% from early 2005, and the number of Realtors has risen 57% since 2001, to 1.2 million. Plus, Web-based startups are still pouring in, highlighted by the debuts of automated appraisal site Zillow.com and Redfin, a Seattle discount broker.

The combination of slumping sales, a glut of agents, and an influx of aggressive rivals has traditional real estate brokers scrambling to devise new ways to move property. They're not just cutting commissions or prices. Many are adding services, too. Edina Realty, the biggest brokerage in Minnesota, is fighting a 30% jump in the number of homes on the local market by offering free warranties worth $400 and a one-year reduction in the mortgage's interest rate, says general manager Barbara Jandric. Iowa Realty in Des Moines is letting consumers choose a limited-service, flat-fee plan that costs $3,795, about 2% of the average local house. "We'd like to protect our fee, but we need to separate ourselves," Jandric says.

Other companies are investing in technology. Cendant Corp. is laying out $50 million to upgrade its online presence. Others are working with referral services such as newcomer Legacy or IAC/InterActiveCorp's RealEstate.com and LendingTree. These businesses take a split of agents' commissions and give consumers rebates or gift cards worth up to $2,000. "February was our first down month in seven years," says Stephen W. Baird, president of Baird & Warner in Chicago. "Anything that moves and says it has leads, we'll try it."

THE LOW ROAD
More home sellers are moving to cut-rate firms such as 3% Foxtons

And the 6% industry-standard commission is under fresh pressure, as Barbara can attest. The national average has fallen to 5.1% and could dip below 5%, industry consultant Steve Murray says. Consumers persuade full-service agents to come down or hire discounters such as New York's Foxtons, which charges 3%. "In high-end markets, 4.5% is the new 6%," says Murray.

Given the pressures, brokerage profits are sluggish. Cendant, which franchises Coldwell Banker and Century 21 and directly owns 1,100 offices, says 2006 pretax earnings will be flat. Upstarts are struggling too: Web discounter ZipRealty Inc. and agent-referral service HouseValues Inc. saw shares pummeled when they said earnings would be weaker than predicted. That buoys the hopes of full-price players. "In a moderating market consumers choose the firms that are the best marketers," Cendant Real Estate CEO Richard A. Smith argues.

Now that consumers hold the power, agents are more willing to negotiate for business. Just as last year sellers charged what the market would bear, this year buyers can push hard to get a deal.

–With Dean Foust in Atlanta

Perception Vs. Reality

Real estate brokers report sustained pressure on traditional commissions in a softer, more competitive market

QUOTED COMMISSION	AVERAGE COMMISSION
6%	5.1%

Data: REAL Trends Inc.

risk for a price correction." Florida and California dominate this historically adjusted list. Boston and New York look more reasonable by this measure, and San Francisco appears a bit less bubbly. Texas still comes out looking cheap.

Yet another way to identify a problem area is to compare rents to sales prices. The idea here is that if people's monthly payments to own a house are much higher than what they would spend to rent the same place, tax considerations included, then they must be banking on prices going up so they can sell for a profit someday. That leaves them exposed if prices don't rise. By this measure, San Diego is one frothiest areas of the country. But Tampa, Orlando, an York, which come out as expensive by some other me aren't so costly by this one.

This year millions of American households will buy a The process will always be lengthy and a big deal. But w you are a buyer or seller, you don't have to fee so lost. ■

–With Toddi Gutner and Timothy J. Mullaney in Ne Christopher Palmeri in Los Angeles, and bureau

COMMENTARY

BY MICHAEL MANDEL

Think of It As a Return to Normal

I see a slow-motion drop over several years—with some areas getting slammec

IS A HOUSING BUST on the way? The question has a familiar ring. Since 2001 economists and journalists have with great regularity predicted an imminent crash in real estate prices, including a 2004 story in *The New York Times* with the headline "The Housing Bust: It Won't Be Pretty." Despite the predictions, however, home prices continued to rise, clocking in double-digit gains over the past two years.

Now it's my turn to take a whack at the housing piñata. I believe there's a good chance that real estate will follow a similar path as the stock and tech markets: a long boom followed by a decline of several years that gradually brings back values to the long-term trend.

If the housing market repeats this pattern, the result would be a slow-motion decline of 10% or so in national home prices, the equivalent of giving back a year or two of gains. Some regions, of course, would be hammered. A drop of this magnitude would be well worthy of the term "bust."

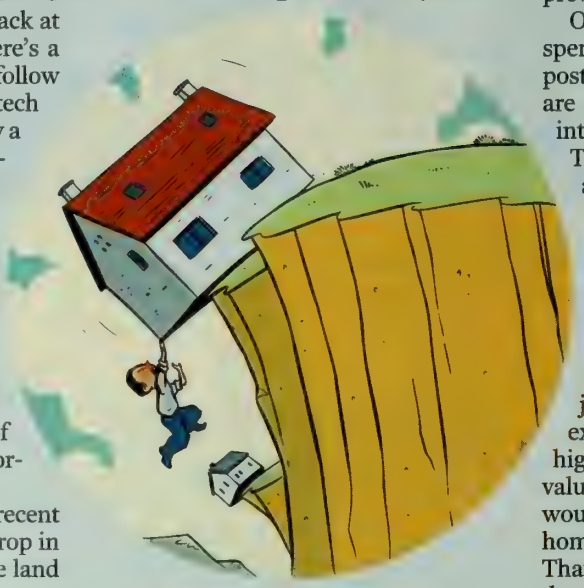
Especially hard hit will be recent buyers with a lot of debt as the drop in prices sends them, sadly, into the land of negative equity. Other homeowners would feel excruciating financial and psychological distress as paper gains melted away. Even the real winners—people who formerly couldn't afford to purchase—will feel anxious and paralyzed as home values fall.

Still, it's better to think of the housing bust as a return to normal r than the end of the world. That' lesson of the stock and tech cra For one thing, after a decade of b bust, and recovery, the Standa Poor's 500-stock index today is higher, adjusted for inflation, th was in 1995. Thus, stock prices r an annual real rate of 6.3% ove past decade, just below the rate c previous 15 years.

Or look at information techn spending by businesses. Despit post-2000 tech bust, such purc are 50% higher than in 1995, t into account economywide infl That translates into an annual age sales gain of 4.3%, rough same growth rate as 1985 to and somewhat slower than t year average.

If housing were to return long-term trendline, what v that mean for prices? Ove past five years home price justed for inflation, have risen extraordinary 6.8% annually higher than the historical 1%. T values back on the long-term would require a 20% drop in na home prices by 2010 in real t That's equivalent to a roughly drop in the actual number of d buyers have to shell out.

A housing bust is hardly a thing. Asset markets—and your is certainly an asset—are notori unpredictable. But whether you buyer or seller, it's worth takin possibility seriously.



Real estate may go down the same path stocks and tech did: Long-term net gain

Optimizing Plastics BAYER Increasing Safety

Science For A Better Life

Every day, more and more people are realizing the benefits of impact-resistant plastics in a wide range of sports and recreation products.

Eyeware producers like UVEX, for example, rely on high-tech materials such as Makrolon® polycarbonate from Bayer MaterialScience to create products that set new standards in safety and design. That's why many of its latest sports eyeware lenses are made of the durable, yet lightweight Makrolon® material. Because less risk is more fun in sports.

www.bayer.com

The New Bayer: HealthCare CropScience MaterialScience

EDITED BY
ARLENE WEINTRAUB

INNOVATIONS

Of salt and spices

>> Slashing salt consumption can sometimes lower high blood pressure, but scientists from the George Institute for International Health in Sydney have gone a step further. They came up with a salt substitute that can reduce hypertension more effectively than most dietary changes, and as well as some antihypertensive drugs. Plus, their blend of sodium chloride, potassium chloride, and magnesium sulfate actually tasted like plain old table salt, i.e., sodium chloride, to most participants in a yearlong, randomized trial. These participants should know: They are residents of northern China, where diets contain two to three times as much salt as those of other world populations.

>> A key to pain relief may be sitting on your hot dog bun. A team led by Yale School of Medicine researcher Sven-Eric Jordt isolated a nerve receptor in mice that responds to the compounds found in sinus-clearing mustard oil and garlic. Reporting in the Mar. 23 *Cell*, the team says the receptor, dubbed TRPA1, responds to a natural inflammatory agent that stimulates pain-sensing neurons. It also reacts to lung irritants such as vehicle exhaust, tobacco smoke, and the byproducts of some chemotherapies. Identifying the receptor that responds to such assaults may be the first step toward a pain-relief drug.

–Catherine Arnst

NANOTECHNOLOGY

BUILDING BRIDGES IN A DISCONNECTED BRAIN

SCIENTISTS AT Massachusetts Institute of Technology used nanotechnology to partially restore sight to blind hamsters. Severed connections in the rodents' brains caused the animals to lose their sight. The MIT process enabled brain cells to recreate some broken connections. This could offer hope to victims of stroke, who can suffer speech loss and other impairments.

The MIT team injected the hamsters' brains with a solution containing protein fragments called peptides. The peptides assembled themselves into thin scaffolds made of 99% water and 1% protein. Brain cells then sent branch-like extensions called axons across the scaffolds, reestablishing neural contact. Within six weeks, partial sight was restored.

The scientists believe such a process could one day help stroke patients regain their ability to speak, and might restore some movement in patients with spinal cord injuries.

ENERGY

FUSION: FINALLY FEASIBLE?

FOR DECADES, researchers have been working to harness fusion, the type of nuclear reaction burning inside the sun, for electricity. Fusion produces fewer toxic leftovers than current fission reactors, but it has proven to be a difficult and expensive target. Sandia National Laboratories may have eased the task by inadvertently generating temperatures 100 times hotter than the inside of our sun.

As part of a program to examine aging nuclear weapons, the lab was generating X-rays by zapping spools of wire with 20 million amps of electricity. When the scientists changed from tungsten to thicker bundles of steel wire, they exceeded 2 billion degrees Kelvin, which is equivalent to 3.6 billion degrees Fahrenheit.

There are some skeptics: William Parkins, the late chief scientist at the company now known as Rockwell Automation, wrote in a paper (published posthumously in March) that fusion plants would be far too expensive to be practical. But the Sandia discovery could yield strategies for building small, less expensive fusion reactors. *–Aaron Pressman*

CLEANER WAT

PLANTS WIT A HEARTY APPETITE F HEAVY MET

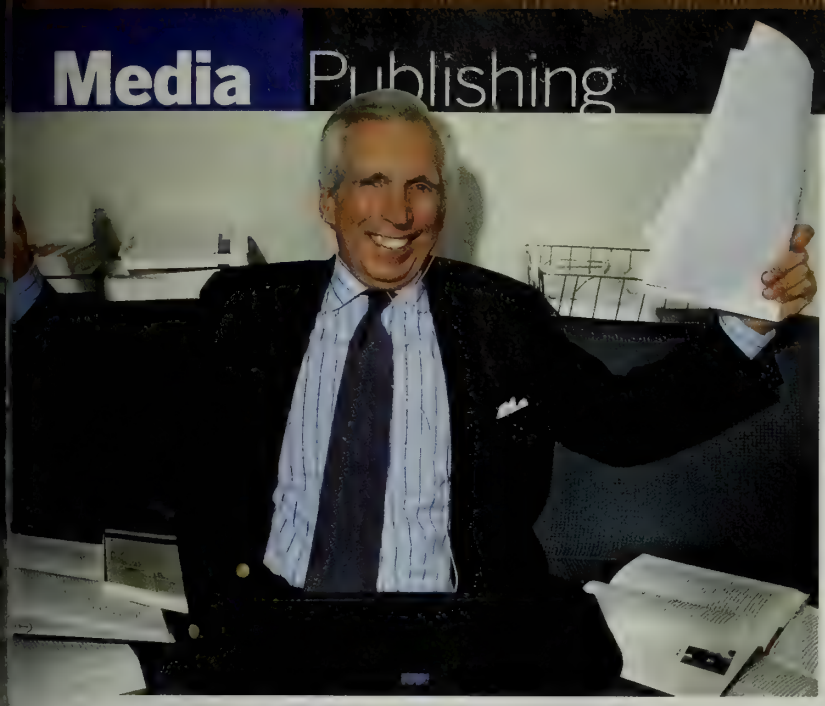
EVEN AS FACTORIES get cleaner, the legacy of a century's worth of indu effluvia persists. Acros U.S., canals, rivers, an are tainted with traces toxic heavy metals sen the drain years ago. O settled into sediment, waste can bind with si making it difficult and to remove.

Now researchers at State University have developed a new techn for cleaning the silt th a combination of ultra and algae. First, focus beams of ultrasound v the metals free from th sediment. Next, the lib metals are passed thro tiny algal buds that ar to trap metals such as

cadmium, copper, me and zinc.

In the lab, OSU's pr captured 30% of the n within minutes and n to 60% during longer exposures. Presented meeting of the Americ Chemical Society in M the findings suggest t system could be easily to boats to dredge an industrial sediments economically than is possible. *–Ad*

COURTESY OF DIRK WIERSMA/PHOTO RESEARCHERS, INC; THOMAS J.PETERSON/PHOTOGRAPHER'S CHOICE/GETTY IMAGES



OSNOS "We just needed a coherent approach. We have one now"

etting Out f a Bind

blishers are testing multichannel very to offer readers more choices

M LOWRY

AT THE TINY TOME ON the Range bookstore in Las Vegas, N.M., nothing gets manager Jillian Rael more steamed than when customers tell her they won't wait for a book to arrive on order. They ather drive the hour or so to San- buy it sooner at a chain store. The -old Tome's location in the s of the Sangre de Cristo Moun- akes it tough to restock quickly. of that, to fill orders, Rael says she as to buy more books than she o meet publishers' quotas, only to em back. "The system is pretty efficient," fumes Rael. "It hurts us customers."

the two-decade-old concept of ime inventory is catching up to quated book biz. A new scheme be announced in early April, the Caravan Project, calls for o be delivered simultaneously in mats—hardcover, digital, audio, -demand, and by chapter. The initiative is the brainchild of Peter Osnos, a publishing veteran and founder of nonfiction imprint PublicAffairs. He figures that publishing's ancient habits are holding it back, keeping it "some sort of relic to Gutenberg." Following the lead of Hollywood mavericks such as billionaire producer and theater owner Mark Cuban, who advocates releasing movies on the same day to theaters, on DVDs, and to TV, Osnos argues that readers should be able to read books when and how they want. By creating a menu of choices for consumers (table), the industry could go a long way toward making the distribution of its books more cost-efficient. "The technology is here," says Osnos, 62, a onetime foreign correspondent at *The Washington Post*. "We just needed a coherent approach. We have one now."

NAPSTER NIGHTMARES

SIX NONPROFIT publishers (three are university presses), No. 2 retailer Borders Group, a few independent bookstores (not Tome on the Range, however), and publishing wholesale powerhouse Ingram Industries are participating in Caravan. The first step: Publish 24 books initially across the five formats in early 2007. Funded by a $250,000 MacArthur Foundation grant, the project is relatively small, Osnos admits. "But we don't have to be big," he adds. "We just have to show that this model is irresistible to everyone in the chain—to authors, publishers, and booksellers. We can't continue to print 10 books to sell 6." Adds Tom Dwyer, director for adult trade books at Borders: "We never want to underestimate the public's desire for information and choices. This lets us put our foot in the water."

But talk of going this far this fast unnerves publishers. Publishing giants such as Random House and HarperCollins Publishers already feel huge pressure to sell digital versions of their books, especially from Google and Yahoo!, which want to deliver books the same way. They argue they are moving in the right direction. Audio books, while expensive to produce, have been around for years, they say, and the quality of print-on-demand books has improved. Just the same, "they are terrified of being Napsterized," says Al Greco, senior researcher for the nonprofit trade outfit Book Industry Study Group.

Books: How Do You Want Them?

A new business plan calls for books to be delivered simultaneously in five formats. Here is the menu:

HARDCOVER The tried and true. Readers have been doing it this way for 600 years.

DIGITAL For sale online and for e-book readers.

AUDIO New software enables text to be converted to a simulated voice, lowering production costs and allowing for more audio books.

PRINT-ON-DEMAND A store doesn't have your favorite best-seller on its shelves? No problem. Go to the clerk and have it printed out from kiosks that will eventually be on the premises.

PIECEMEAL Allows you to buy chapters or portions of the book, either by print-on-demand or online.

Data: The Caravan Project

"So turning over their books to electronic files for use in print-on-demand may not be viable because of the risks."

The all-at-once approach is also scaring some authors, who prefer the release of just the hardcover first. "At the risk of sounding vulgar, I make more royalties when a book is sold in hardback," says Simon Winchester, whose latest work, *A Crack in the Edge of the World: America and the Great California Earthquake of 1906*, was published in October. Still in hardcover, it could see a surge in sales from publicity surrounding the disaster's centennial in April. Coming out in many formats on the same day, Winchester says, is akin to "a film going straight to video."

But the industry could see as much as a 15% increase in net sales under the Caravan Project model, Osnos projects. Sales of all books in the U.S. last year were $25 billion, according to the Association of American Publishers, up 10% from 2004. Not only would publishers see a bump from additional sales of more audio and digital offerings, Osnos figures, but print-on-demand would help cut down on large returns of inventory. Last year 33% of adult hardcovers were returned by stores to publishers, says the Book Industry Study Group. Publishers have never been good at gauging demand, and returns—known in the industry as "rotting fruit"—have been a big drain on profits.

Industry sales could rise 15%, Osnos predicts

Having the ability to quickly print and deliver books on demand, eventually using in-store kiosks, could help tremendously. Osnos says that could be invaluable to a seller, especially after a wave of publicity ratchets up demand. Today a book can be printed and glued together in under 10 minutes and shipped out in 24 hours, says J. Kirby Best, president and CEO of Lightning Source Inc., the print-on-demand unit of Ingram.

Making books available in more ways could even help ease the industry's other chronic headache—booming used-book sales, which, at more than $2 billion a year, deliver no royalties to publishers and authors. "There is no reason for you to go into a store," says Osnos, "ask for a book, and not leave with it." ■

It's a Little Easier Being Green

Consumers and companies are giving alternative energy a boost with "green ta

BY HEATHER GREEN

MARTIN HUGHES IS not your typical hybrid-driving, clean-energy fanatic. Hughes and his wife, both longtime oil-industry veterans, zoom around Houston in no-compromise vehicles. His, a Nissan Xterra SUV. Hers, a zippy Volkswagen Passat.

Yet when Hughes heard last year about an environmental startup called TerraPass Inc., he was intrigued. The Menlo Park (Calif.) company sells "green tags," which cost up to $80 a year and which are designed to offset the emissions a car spews into the air during that period. After taking a small cut of each sale, TerraPass pools its members' fees and invests them in clean energy production, including wind power. Hughes checked out the service online last August and then forked over $129 for two TerraPass windshield decals. "I was impressed," he says. "It's a for-profit product that allows you to exercise your conscience."

TerraPass is channeling the good intentions of individual consumers concerned about carbon emissions, which are linked with global warming. U.S. companies are also adopting the certificates, in part because they wish to this growing, green constitue the tags, which are now Ar fastest-growing alternative-ener uct, aren't simply a marketing U.S. businesses have watched and Japan adopt tough regulat carbon emissions and say the ta help them prepare for similar d ments in the U.S.

Starbucks Corp. has been a le the green-tag movement, mai cause renewable power is still come by. Last year, Starbucks pledge to buy 20% of the annual power for its North American about 150 million kilowatt hour renewable sources. But no sing farm can service all 8,400 of its fee shops. In fact, many Starbuc no means of hooking up to any able power producer.

So Starbucks stores continue sume power as usual, but the c passes an extra payment of le half a cent per kwh to a mid called 3 Phases Energy Service Francisco. 3 Phases redistribute to 40 wind farms across the then issues a certificate. With t sidy, the farms cut the price power and boost sales to lo

Combating Climate Change

Windmills and solar farms generate earth-friendly electrici they can't service all the households and companies that want their power. Also, their costs are often higher, so they easily compete with coal, natural gas, or other fuels that re CO_2. Businesses and consumers can help level the playing purchasing "green certificates." Here's how they work:

CLEAR CONSCIENCE Hughes (with son, Finn) bought TerraPass tags for both family cars

The net effect: Nationwide, an of power equal to Starbucks' e is shifted to wind and away nventional "dirty" sources. t of companies is now using this pe of transaction to meet renew-rgy targets, slash emissions, and heir brands stand out. Whole Iarket Inc., based in Austin, Tex., o certificates in January, when it to offset 100% of its energy con-n with renewables. Whole Foods became the biggest corporate such tags in the U.S. Safeway, Liz ne, and HSBC have also made ma-ges in the past year. "We'll see nd more reliance on [tags]" in months, says Blair Swezey, a policy adviser at the U.S. National Renewable Energy Laboratory in Golden, Colo.

Green tags come with a cost. For big purchases, the certificates can tack an extra 0.5% to 8% onto an energy bill. "It's not a financial hardship, but it is an incremental amount of money that's not required," says Steve McDougal, senior manager of business development at 3 Phases, which also supplies green tags to Johnson & Johnson and IBM. Still, the premium that most companies pay for green tags works out to far less than they would pay to buy renewable power directly from a patchwork of suppliers, McDougal says.

Now utilities are snapping up green tags as they scramble to meet new renewable energy regulations. To date, 23 states have adopted requirements that power companies replace a portion of the energy they sell with renewable power. California is committed to a goal of 20% by 2017, and New York has to hit 25% by 2013. In many cases, green tags offer the easiest path to meet the new minimums.

For retail operations such as Starbucks and Whole Foods, the tags help attract a green clientele. For industrial companies such as DuPont, Staples, and J&J, green tags are also a way to meet, or anticipate, regulations. With the carbon-restricting rules of the Kyoto Accord in effect in Europe, Canada, and Japan, many such companies are trying to align their U.S. operations with global practices. "We need to understand how to do business as a company in a carbon-constrained environment," says Mark Buckley, vice-president for environmental affairs at Staples Inc., which aims to reduce its emissions by 7% by 2010. Meanwhile, a clutch of state-backed and nonprofit auditors, such as Green-e in San Francisco, is trying to standardize how tags are measured and tracked.

While many companies are just beginning to experiment with green certificates, individuals are using them to offset the power consumed in everything from cross-country flights to wedding receptions and ski trips. At Mt. Hood Meadows Ski Resort, an hour east of Portland, Ore., 18,000 skiers purchased green tags this year. One was Allen Engle, an electrical engineer in Bend, Ore. He buys a $2 green tag along with his $48 lift ticket, to compensate for the power consumed on his day trip to the slopes. "To get any new technology started, you need incentives, like tax incentives," says Engle. For many companies and consumers, tags are an acceptable short-term cost.

1 ember, s promised 20% of its 150 million s (kwh) per newable many of its stores are not wind or solar farms. So ys regular dirty power for ons, then pays an extra fee to to help offset the emissions.

2 The middleman, 3 Phases Energy, has contracts with wind projects across the U.S. 3 Phases transfers Starbucks' money to these wind farms, which use the subsidy to lower their own prices so that they can sell power to nearby customers at competitive rates. This encourages consumption of green power equal to the 20% target that Starbucks has set.

3 A nonprofit called Green-e watches over the deal, checking details such as the payment terms. This guarantees that the middleman and windmills don't accept additional subsidies for the same wind power. 3 Phases issues Starbucks a "green certificate" confirming the transaction.

HP Wants Your Old PCs Back

It's pushing states to force recycling of TVs, computers, and other e-gear. Here's why

BY LORRAINE WOELLERT

A FEW YEARS AGO, when environmentalists in Washington State began agitating to rid local dumps of toxic old computers and televisions, they found an unexpected ally: Hewlett-Packard Co. Teaming up with greens and retailers, HP took on IBM, Apple Computer, and several major TV manufacturers, which were resisting recycling programs because of the costs.

Aided by HP's energetic lobbying, the greens persuaded state lawmakers to adopt a landmark program that forces electronics companies to foot the bill for recycling their old equipment. "This bill puts our market-based economy to work for the environment," said Washington Governor Christine O. Gregoire as she signed the plan into law on Mar. 24.

The movement to recycle electronic refuse, or "e-waste," is spreading across the nation, and so is HP's clout. The company helped the greens win a big battle in Maine in 2004 when the state passed the nation's first e-waste "take-back" law. Washington followed suit. Now, Minnesota and J sey are preparing to act, and 19 oth are weighing legislation. Activists banish high-tech junk from lanc scrub the nation's air and water chromium, mercury, and othe prevalent in digital debris.

BIG BUSINE
HP recycle than 70,00 of product

HP's efforts have made it the d environmentalists. They say t laws are more effective at gettin junk recycled than point-of-s which tax consumer electronics to fund state-run recycling p They're also pleased because programs in the U.S. reduce t hood that the products will be sh less developed countries and d bled under unsafe conditions.

But HP's agenda isn't entirely tic. Take-back laws play to the co strategic strengths. For decades puter maker has invested in recy frastructure, a move that has lo production costs, given it a leg secondary market for equipmen

it to build a customer service out of management," which includes ion of data that might remain on led gear.

2005, HP recycled more than tons of product, the equivalent of 10% of company sales and a 15% e from the year before. And it col- more than 2.5 million units (in ex- 25,000 tons) of hardware to be re- ed for resale or donation.

ther electronics maker has a resale ss on this scale. But the oth- y soon wish to emulate HP. e legislation coming," says Lear, HP's vice-president for ate, social, and environmen- onsibility. "A lot of compa- aven't stepped up to the If we do this right, it be- an advantage to us."

television makers, on the and, take-back laws are ter- Following the lead of PC , they're pushing con- to replace their bulky tele- ets with flat-screen models, of them primed for high- on viewing. As a result, in t three years, Americans are d to throw out more than illion analog TV sets and er monitors that contain ds of tons of lead. The last hese companies want are -coast take-back laws.

e than a dozen consumer nics companies, including nic, Sony, and Philips, have a group called the Manu- s Coalition for Responsible ng. Backed by IBM, Canon ple, they have dispatched ts to statehouses across the pushing bills that mirror ia's somewhat weak recy- ogram. Instead of forcing cturers to take back waste, uld impose a levy of up to sales of products to help over recycling costs with- dening equipment makers.

e-waste skirmish is part of ortant new front in global mentalism called product ship. Proponents argue mpany's responsibility for what it uld include collection and disas- at the end of the product's life cy- slogan, product stewardship has ound since the Earth Days of the ut it is now a serious force in the d electronics sectors of Japan and The movement is likely to broad- en in the U.S. as well. Several states are strong-arming auto makers into using less toxic parts, persuading thermostat manufacturers to fund bounties for the return of old mercury-laden devices, and pushing pharmaceutical giants to redesign packaging to reduce waste and accept unused medications for disposal.

But manufacturers have many concerns, including the fact that take-back laws such as Maine's allocate costs based on the weight of the junk consumers re-

Get the Lead Out

With America awash in e-waste, including discarded laptops, TVs, computer monitors, and other parts, there is a growing call for "take-back" laws

CALIFORNIA	Levies a sales tax of $6 to $10 on such devices to help fund recycling programs
MAINE	Bills manufacturers to cover recycling costs
MARYLAND	Asks manufacturers to chip in on a five-year recycling pilot program
WASHINGTON	Will offer manufacturers a choice: Pay for recycling or take back used products

Data: Computer TakeBack Campaign

turn. Consider the implications for big picture tubes: A company like LG Electronics, which owns the Zenith brand, could end up being responsible for heaps of old Zenith TVs, even though LG's market share is relatively small. And IBM, which has abandoned the PC market, might still be forced to recycle millions of machines bearing its logo. "They're really discriminating against legacy manufacturers," says coalition spokesman David A. Thompson, director of Panasonic Corp.'s Corporate Environmental Dept. "New market entrants have no waste stream. They're getting a free ride in Maine and Washington."

BRUISED APPLE

ENVIRONMENTALISTS' biggest disappointment has been Apple Computer Inc. The company's progressive image, loyal customers, and retail network make it a natural for a take-back program. Yet Apple has fought such programs, and it lags behind HP and Dell Inc. in voluntary recycling. During Maine's legislative fight, "they were doing more than any other manufacturer to fight the bill," says Jon Hinck, staff attorney for Maine's Natural Resources Council.

When shareholders at last year's annual meeting hit Apple over the Maine bill, CEO Steven P. Jobs publicly dismissed the gripe with a barnyard profanity. This year, green groups have put a resolution on the agenda of the Apr. 27 shareholder meeting that directs Apple to study how to boost recycling. "They are laggards in a number of ways on the issue of e-waste. It's come to the point where we need to have the company confronted," says Conrad MacKerron, director of the corporate social responsibility program at As You Sow Foundation, a green advocacy group that pushed the resolution.

Apple says critics ignore the company's efforts to use recyclable and clean materials in its products. It has cut lead use and says that, by weight, 90% of Apple computers can be recycled. Their sleek designs and spare packaging also mean less waste, says Chief Operating Officer Timothy D. Cook. "It's important to look at the whole of the process," he says, "not just one part." Cook also argues that take-back programs overlook a key fact: "Recycling is a responsibility of the person who makes the product, the people who use the product, the people who sell the product, and the government."

If Apple hopes to catch up with HP, it might have to think harder about the first part of that sentence.

NBTA's Focus *on* Business Travel 2006

Business travel is on the upswing, and so are travel costs. According to the National Business Travel Association's (NBTA) 2006 Business Travel Overview and Cost Forecast, domestic airfares are expected to rise six percent this year, hotel prices are projected to jump nine percent, and car rental prices are predicted to climb five percent. "These cost increases, along with growth in the number of travelers and trips per year, puts the spotlight firmly on travel procurement," said NBTA president and CEO Suzanne Fletcher.

So how are America's most progressive companies sourcing travel, implementing spending controls, and leveraging purchasing power? According to the NBTA, they are following these best practices:

Designate a travel manager. Whether this manager reports to finance, procurement or elsewhere, a subject-matter expert skilled at negotiations, communications and data management can apply industry-specific expertise to strategic sourcing of travel.

Monitor and analyze travel expenditures at an enterprise-wide level. Travel is typically a corporation's second or third largest controllable expense. Understanding patterns – including frequently traveled routes, how far in advance travelers make reservations, seasonal variations, and regional variations – is the first step in spend control. "Many companies are taking a hard look at all areas of travel spend," says Charles Franklin, manager of corporate services, American Honda Motor Company, Inc. "They're creating cost-effective, enterprise-wide approaches to meetings and moving transient travelers to lower-cost or higher-value choices. These efforts may include switching to a different tier or brand of hotel, using secondary airports, or in some markets, traveling by rail rather than air."

Some companies are also taking advantage of new opportunities to collect frequency-program points for empl business flights. The **British Airwa** Business program, for example, all companies to earn points redeemal upgrades, reward flights and hotel To make this option more attracti road warriors, travelers who are Exe Club members also benefit by ear British Airways Miles for personal **Visit www.britishairways.com.**

Enforce travel policy. Travel gui cover everything from how reserv are made (online or with a travel a to when travelers can fly Business (on a flight over five hours or if t traveler is at director level or abov limits on business entertaining.

July Conference to Focus on **Best Practices in Business Travel Management**

The National Business Travel Association's (NBTA) International Convention & Exposition offers opportunities for attendees to lea more about the travel management practices outlined in this sect as well as other best practices and developing industry trends.

More than 5,000 corporate travel professionals from more than 30 natior gather each year for this leading industry event, which features:

- A trade show with more than 400 exhibitors
- A Technology Pavilion showcasing the latest developments in travel management technology
- A variety of opportunities to network with peers
- World-class speakers
- More than 50 seminars covering best practices and the latest developmer business travel
- Several levels of professional development offered in pre-convention sessi

For information on how your company can take part in **NBTA's 2006 Internat Convention & Exposition, in Chicago, July 16-19, see www.nbta.org**

Spa services await you in our Arrivals Lounge.

st service anticipates your needs. To help you arrive feeling ready for business, our Arrivals Lounge at Heathrow h services of a spa. You can step off the plane and straight into a shower, a robe, even a Molton Brown facial - all while s is being pressed. Our goal is simple: to deliver the best service you could ask for, without you having to ask. So whether enjoying a gourmet meal, or our infinitely more comfortable flat bed, we think you'll find our business class like no other.

t ba.com/clubworld

Business class is different on BRITISH AIRWAYS

Yet no policy is effective unless it's communicated and enforced. Best-practice companies communicate regularly through multiple channels to teach travelers and travel arrangers about the travel program and the importance of compliance. Many travel managers also use electronic filters to identify out-of-policy requests at point-of-sale, requiring a manager's approval of such bookings before reservations are finalized. Regular audits, also a best practice, identify problems and new savings opportunities.

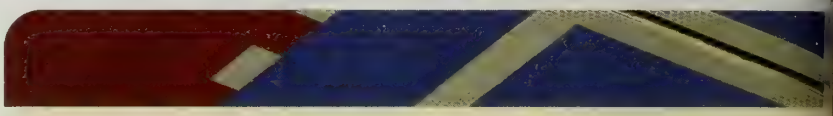
Best-practice companies also adjust policy over time, allowing the program to respond to trends in the marketplace or changes at the company. "A new route launched by a low-cost carrier flying your company's frequently used city-pairs would prompt you to examine existing airline contracts," says Sally Abella, CCTE, director of corporate travel, Harman International Industries, Inc. Likewise, she said, a merger or acquisition may combine a loosely-managed travel program with a highly controlled one, requiring a policy evaluation.

Globalize a corporate card program. By channeling all T&E charges through a small number of corporate cards, spend information can be captured no matter where travelers are based or how they book travel.

Card companies offer sophisticated spend analytics tools that allow companies to aggregate data in meaningful ways. This information is of vital interest not just to your company, but also to vendors willing to provide significant value for corporate clients in exchange for volume or market share commitments.

There are other benefits to card programs. Some offer financial incentives once a certain spending threshold is reached. Most offer supplemental insurance for car renters. Companies can set spending limits, or even issue an event-specific card.

Negotiate corporate travel contracts and discounts. "One of the travel manager's most important strategic functions is to negotiate agreements with airlines, hotels, car rental companies and travel agencies," said NBTA's Fletcher. The agreements should be designed to meet both corporate goals – safety, cost-efficiency, effective employees – and traveler needs – comfort and productivity. On long-haul flights a traveler's comfort crosses both categ ensuring a pleasant trip and a more productive employee. Seats that co into flat beds are a distinct competi advantage for global airlines such a British Airways and Malaysia Airlir



Best-practice companies also adjust polic over time, allowing the program to respon to trends in the marketplace or changes at the company.

Designers of British Airways' Ch World product clearly have trave productivity at top of mind. Passen are given the option of eating dinn the departure lounge so they can g sleep immediately after boarding; c at Heathrow, there's a spacious, mo lounge-cum-spa, where travelers c shower, relax, get their shoes shine clothes pressed, check e-mails, and leisurely breakfast before heading meetings.

Automate the front and the bac By having travelers book their own using an automated, enterprise-w booking tool, companies can signifi cut travel agency transaction fees. while most companies focus on sa opportunities on ticket prices and rates, there are also significant pro savings to be realized by automati business travel expense reporting pr Electronic expense report solutio linked to online booking tools an corporate cards can cut $25-$75 reconciled expense report, on aver Automated reporting solutions im productivity by cutting time empl spend on their reports and cut cos catching and eliminating out-of-p expenditures.

Bringing New Artistry to In-Flight Dining

While other carriers are cutting corners on meals, **Malaysia Airlines** is actually enhancing the dining experience and bringing glamour back to in-flight dining. Well-known chefs from all over the world have developed exciting new menus, a series of award-winning wines has been selected for a cellar-in-the-sky, and a new à la carte service allows passengers to choose from an array of ethnic, vegetarian and organic dishes. There are even personal breadbaskets filled with artisan breads.

Signature dishes draw inspiration from modern French cuisine and authentic Asian dishes. The new menu items, from lamb shank in Sarawak black pepper sauce to baked North Atlantic black cod to satay, are very much in keeping with Malaysia Airlines' philosophy of going beyond expectations. That includes considering the entire fine dining experience, not just the cuisine. Passengers can expect the same attention to details they would get in any top restaurant on the ground. This includes silver cutlery, Italian glassware, Wedgwood tableware, and individual French presses for coffee.

For more information: www.malaysiaairlinesusa.com.

Writer: Julie Moline is a business travel s and a frequent contributor to various cor trade and in-flight publications.

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The S&P/ BusinessWeek Annual Awards

The Best Fund Managers

Just in: The results of the Standard & Poor's/*BusinessWeek* Excellence in Fund Management Awards for 2006

SCREENS AND SCOREBOARDS are great tools for identifying potential investments quickly. But when you get hundreds of choices, you're going to need more help. That's where the 2006 Standard & Poor's/*BusinessWeek* Excellence in Fund Management Awards come in handy. ¶ Fund selection starts with 810 funds rated A or B+ for the five years ended Dec. 31, 2005, in the *BusinessWeek* Mutual Fund Scoreboard (BW—Jan. 23). Our ratings are based on risk-adjusted total returns, an evaluation that favors funds with strong and steady returns, not necessarily those with the greatest gains. We then apply other criteria: assets of at least $100 million, a manager with at least five years' tenure, and a minimum investment of less than $26,000. Also, of course, the fund should be open to new investors. That's the reason two of last year's winners, Julius Baer International Equity and Laudus Rosenberg International Small Cap, are no longer on the list. They're closed to new shareholders. ¶ Once a fund has jumped all those hurdles, S&P's fund analysts conduct in-depth, face-to-face interviews with managers to quiz them on investment practices. (S&P, like *BusinessWeek*, is owned by The McGraw-Hill Companies.)

The result? A list of 18 funds tha feature consistent investmen philosophies and security selectio guided by seasoned pros. "While y can't guarantee future returns, we h confidence these managers can run funds no matter what comes their says S&P mutual fund stra Roseanne Pane. Among the eigh time winners are Janus Mid Cap Fund and Stratton Growth Fund (Repeaters include Bill Miller's Leg son Value Trust and the team-ma Growth Fund of America.

On the pages that follow, you' profiles of four of our newcomer information on the other 14 fu plus Q&As, free S&P reports, and o er fund-picking tools, go to BusinessWeek Online (box) Choosing funds is a lot easier if knowledgeable folks have already done some of the work. ■

–Lauren You

Our First-Time Award Winners

FUND / SYMBOL	CATEGORY	PORTFOLIO MANAGER
Fidelity Short Term Bond FSHBX	Short Bond	Andrew Dudley
First American Real Estate FARCX	Real Estate	J. Wenker/J. Rosenberg
Goldman Sachs High Yield GSHAX	High Yield	A. Jessop/R. Golder
Janus Mid Cap Value JMCVX	Mid-cap Value	T. Perkins/R. Perkins/J. Kautz
Oppenheimer Main St. Small Cap OPMSX	Small-cap Blend	N. Monoyios/M. Zavanelli
Stratton Growth STRGX	All Cap	James Stratton
Templeton Global Bond TPINX	Intl. Bond	A. Calvo/M. Hasenstab
Thornburg International Value TGVAX	Foreign	W. Fries/W. Trevisani/L. Wang

BusinessWeek online For more on the Excellence in Fund Management Awards, businessweek.com/go/06fundmanagers You'll find profiles of all 18 winning fun Q&As with several managers, a slide sh and a video view with S&P's Phil Edwa In addition, there are free S&P reports each of the award winners

N THIS SECTION:
Swedish spirit's aring flavors
99 Digitizing the family photos
100 GM's Great Wide Hope
102 Plus: ETF-based annuities

Value in The Genes

Janus Mid Cap's Perkins brothers can spot bargains

JANUS MID CAP VALUE Fund has always been an outlier in the Janus empire. Its managers, with offices in San Francisco and Chicago, operate independently of Denver-based Janus. While Janus is synonymous with earnings-driven growth stocks, the team that runs the $5.8 billion mid-cap fund zeroes in on value-priced equities.

Their searches led them to the energy sector in 1999, when oil was trading near $13 a barrel. "We aren't great economists or energy analysts," says Tom Perkins, 61, who leads the fund with his older brother, Bob, 65. "But it seemed to us that [number] was probably out of bounds for the price of energy."

JANUS MID-CAP VALUE

CATEGORY
Mid-cap Value

PORTFOLIO MANAGERS (L-R)
Jeffrey Kautz
Thomas Perkins
Robert Perkins

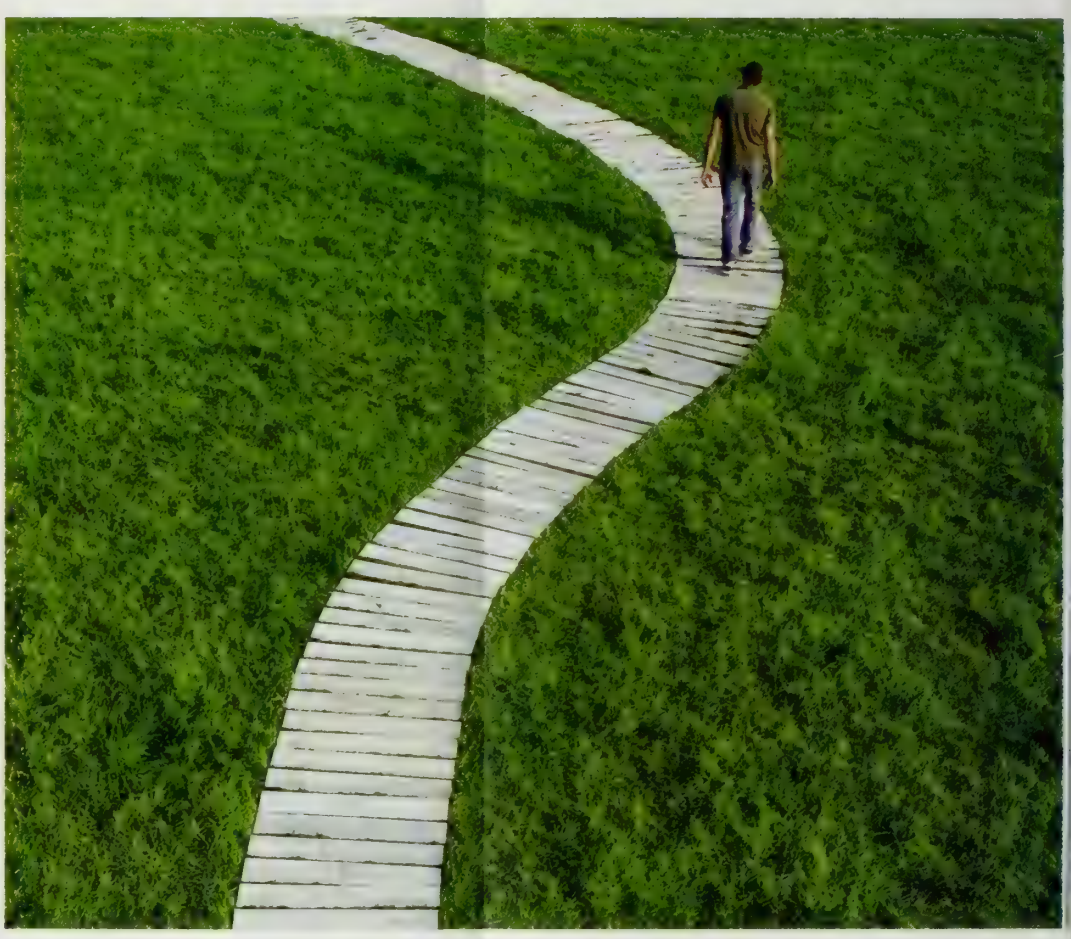
AVERAGE ANNUAL TOTAL RETURN*
13.8%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2001-2005

An oversized bet on energy companies helped fuel the fund's annualized 13.8% gain in the 2001-2005 period. The team, which includes 37-year-old Assistant Manager Jeff Kautz, recently cut the fund's energy weighting to 10%, from 15%, and shifted emphasis to production companies such as Noble Energy and Anadarko Petroleum. "We feel more comfortable having the assets in the ground," Perkins says.

In order to stay focused on the risk-reward tradeoff, the trio sets targets, ideally a 40% potential gain with a worst-case loss of no more than 20%. "We are much more concerned with how the fund performs on the downside than with how we

Ask yourself.



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100% No-Load Funds	Average annual total returns as of 12/31/05 1 Year	5 Year	10 Year
Balanced Fund	5.52%	4.47%	8.27%
Lipper Balanced Funds Average	4.69%	2.67%	7.17%
Capital Appreciation Fund	6.85%	11.37%	12.40%
Lipper Multi-Cap Value Funds Average	6.37%	5.42%	9.70%
Global Stock Fund[1]	22.74%	4.13%	9.22%
Lipper Global Large-Cap Growth Funds Average	10.17%	-0.89%	6.47%
Growth Stock Fund	6.56%	1.38%	9.92%
Lipper Large-Cap Growth Funds Average	6.20%	-3.99%	6.67%
Spectrum Growth Fund	9.47%	4.59%	9.31%
Lipper Multi-Cap Core Funds Average	6.58%	1.65%	9.01%

When assessing performance, investors should consider both short- and long-term returns. Current performance may be lower or higher than the quoted past performance, which cannot guarantee future results. Share price, principal value, and return will vary, and you may have a gain or loss when you sell your shares. To obtain the most recent month-end performance, call us or visit our Web site. Request a prospectus or a briefer profile; each includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing. All mutual funds are subject to market risk, including possible loss of principal. International investing has special risks, including currency fluctuations. [1]The performance information shown does not reflect the deduction of a 2% redemption fee on shares held for three months or less. If it did, the performance would be lower.

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verage annual total return figures include changes in principal value, reinvested dividends and capital gain distributions. ***Based on cumulative total return, 97 of 138, 74 of 3, and 47 of 64 T. Rowe Price funds (including all share classes and excluding funds used in insurance products) outperformed their Lipper average for the 1-, 5-, and 10-year eriods ended 12/31/05, respectively. Not all funds outperformed for all periods. (Source for data: Lipper Inc.)

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The result? A list of 18 funds that feature consistent investment philosophies and security selection guided by seasoned pros. "While we can't guarantee future returns, we have confidence these managers can run funds no matter what comes their way," says S&P mutual fund strategist Roseanne Pane. Among the eight first-time winners are Janus Mid Cap Value Fund and Stratton Growth Fund. Repeaters include Bill Miller's Legg Mason Value Trust and the team-managed Growth Fund of America.

On the pages that follow, you'll find profiles of four of our newcomers, information on the other 14 funds, plus Q&As, free S&P reports, and other fund-picking tools, go to BusinessWeek Online (box). Choosing funds is a lot easier if knowledgeable folks have already done some of the work. ■

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*Based on fiscal year-end data available as of 12/31/05. (Source for data: Lipper Inc.)

**Please note that the Retirement Funds should not be considered a complete retirement solution. When planning for retirement, you should also think about factors such as needed emergency ca the amount of equity in your home, and your life and health insurance options. Before investing in one of these funds, be sure to weigh several factors, such as your objectives, time horize tolerance, as well as your retirement needs and other sources of income.

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do on the upside," says Perkins.

The managers take profits when stocks reach those price targets. That happened in 2005, when they sold longtime holdings Legg Mason and Franklin Resources and replaced them with a languishing Alliance Capital Management. With a 6% yield and a full line of global investment products, Alliance Capital looked like a smart bet. Since then, the stock has gained 42% and has become the fund's largest holding.

Finding those deals is tough, which is why the fund has 13% in cash. Perkins doesn't expect to put that money to work anytime soon. "The values aren't there the way they used to be," he says.

In their spare time, the Perkins brothers practice philanthropy. Tom supports reproductive rights g while Bob sponsors a charter scl Chicago and other educational tives. Kautz is involved in educ programs, too. Since nearly all c money is invested in the fund, the the performance, the more they l give away. ■

–Lauren

Eye on the Small-Fry

This Oppenheimer fund juggles 1,200 stocks at a time

ONE WAY TO RUN A MUTUAL fund is to make a handful of big bets on stocks and hope for a few home runs. The funds that do that often make headlines when they win—and lose. Nikolaos Monoyios and Mark Zavanelli take the opposite approach in Oppenheimer Main Street Small Cap Fund. With tiny positions in some 1,200 stocks, they're aiming for lots of base hits. For the 2001-05 period, they earned an average annual return of 12.7%, vs. 8.2% for the benchmark Russell 2000 index.

To keep tabs on so many stocks, Monoyios, 57, and Zavanelli, 35, use a quantitative model that collects massive amounts of data about the companies and stocks' trading patterns, and they adjust their holdings as market conditions change. That means they might trade 300 stocks in a week. About 80% of the time, adjustments are made with "program trading"—the buying or selling of a large basket of stocks.

OPPENHEIMER MAIN STREET SMALL CAP

CATEGORY
Small-cap Blend

PORTFOLIO MANAGERS (L-R)
Nikolaos Monoyios, Mark Zavanelli

AVERAGE ANNUAL TOTAL RETURN*
12.7%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2001-2005

Zavanelli has been running this small-cap fund for six years (Monoyios joined in 2003), but their quantitative model is a work in progress since factors that helped identify trends a year ago don't necessarily work now. "We believe in continuous improvement," Monoyios says.

If the model is positive about a stock, Zavanelli and Monoyios will increase its weighting vs. the Russell index. Likewise, they'll pare the position if their model cools on it. "Some people say it looks like an index fund," Zavanelli admits, but his partner quickly notes that the fund's returns far exceed the index. "There's no way anyone can accuse us of being an index fund."

Right now, the managers have upped the ante in technology and consumer discretionary sectors (such as retailing, restaurants, and entertainment) and are underplaying financial and health-care stocks. They have also cut the portion of the fund in the smallest stocks, known as micro-caps, and boosted mid-caps, given their view that the outsize gains of small stocks over the past six years can't go on much longer. "We try not to fall in love with stocks or become overconfident," says Monoyios, "because something very bad could happen." Something like a long string of strikeouts. ■

–Karyn McCormack

They Kno Real Estat

The hands-on manager behind First American

JOHN WENKER AND JAY I berg are real estate junkies ing to the airport after a ence in Palm Beach in Mar took a detour to a two-acre lot owned by Kite Realty Group ing in the $740 million First A Real Estate Securities Fund, wh jointly manage. The land won' veloped for more than a year. M estate fund managers wouldn bothered to peer at a weed-fille

But Wenker and Rosenberg look into each company's pip projects using skills they picked lier in their careers. Wenker, 54

ROSENBERG AND WENKER

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start in the 1970s working for the city of St. Paul, Minn., first assessing property and later overseeing new developments. Rosenberg, 34, built industrial buildings in the Midwest before becoming a fund manager. "We have hands-on experience, and we like to get out and take a look," says Wenker.

Their diligence has helped First American produce annualized gains of nearly 20% in the 2001-2005 period, about one percentage point better than the average real estate mutual fund, according to Standard & Poor's. Unlike many of their competitors, the managers also look beyond real estate investment trusts (REITs) to operating companies, such as Hilton Hotels, that have substantial property on their balance sheets. Such outfits don't necessarily pay dividends as high as REITs, but they often trade at a substantial discount to the trusts and provide a cushion when the market turns against the sector. That has helped First American outperform in weak REIT markets, like the one last summer. "We're looking at a lot of companies a lot of our peers have never even heard of," says Rosenberg.

Another overlooked segment, small-cap REITs that aren't followed by Wall Street analysts, have also proven profitable. The duo put almost 2% of the fund into tiny First Potomac Realty Trust, with a market capitalization just under $600 million, which gained 17% last year. First Potomac's savvy management bu derutilized office and in al properties in the Wa ton (D.C.) area.

After a tremendous year run in the REIT average dividend yiel below that of the 10-ye Treasury bond, a dang nal in prior rallies. Bu siderable mergers-and- sitions activity has help sector post strong pe ance, says Rosenberg. interest rates will eventually deter buyers. "We're due for a little pay says Rosenberg. With its quirky though, the fund should outperfo peers even in a downturn. ■

–*Aaron Pre*

FIRST AMERICAN REAL ESTATE

CATEGORY
Real Estate

PORTFOLIO MANAGERS
John Wenker, Jay Rosenberg

AVERAGE ANNUAL TOTAL RETURN*
19.9%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2001-05

Any Stock is Fair Game

James Stratton has picked winners of all stripes since '72

THE TERM THAT MOST APTLY describes James Stratton is "old school." Stratton, 69, has been managing money since 1960, and the $175 million Stratton Growth Fund since 1972. In fact, the fund is so old that Stratton says it may be mislabeled by today's standards. "When we put 'growth' in the title, the mutual fund market wasn't divided into growth and value investing," he says. "We just wanted the money in the fund to grow."

STRATTON GROWTH

CATEGORY
All Cap

PORTFOLIO MANAGER
James Stratton

AVERAGE ANNUAL TOTAL RETURN*
11.7%

*Appreciation plus reinvestment of dividends and capital gains before taxes, 2001-05

Indeed, the *BusinessWeek* Mutual Fund Scoreboard categorizes Stratton Growth, based in Plymouth Meeting, Pa., as an all-cap fund because Stratton buys stocks in companies of all sizes. He finds them by ranking shares on six valuation criteria, including price-earnings and price-to-cash-flow ratios, as well as some growth-oriented momentum stats, such as one that measures the rate of change of analysts' earnings estimates. About 70% of the ranking is determined by value criteria and 30% by growth criteria. "I don't want to buy a cheap stock that just sits there," Stratton says. "The company needs some sort of catalyst for improvement."

Stratton says the fund's flexibility is an advantage, allowing him to own a worldclass blue chip such as Caterpillar, which has a $50 billion market cap, alongside oil-exploration company Penn Virginia, with one of $1.2 billion. Currently he prefers energy stocks, particularly small ducers, which tend to hav valuations and are in a be sition to benefit from hig prices than majors su ExxonMobil.

He also favors r stocks Burlington No Santa Fe and Norfolk ern, which have market upwards of $20 billion. are no small railroad c nies," he notes. "If this small-cap fund, I'd b out." He's bullish on t because they're more fu cient than truckers and er for shippers to use.

Since launching on S 1972, the fund has gar 4,118% cumulative ret 12.14% annualized, vs. or 11.12% for the Stan Poor's 500-stock inde one percentage point ence doesn't sound lik but over 33 years it add

Stratton attributes his success to a cautio mism, something he doesn't see n today. "The level of cynicism is greater today" than in the '70s, "Now when a company comes o earnings, all people want to do is what's wrong with it. If you g news, the stock still goes down. think it's a healthy attitude. It everybody too short-term oriented nearly half a century of investing his belt, this is one manager no on accuse of thinking short term. ■

–*Lewis*

S GROWTH COMING BACK?
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d (inception date) egory	1-Year	3-Year	5-Year	Life of Fund
nus Adviser Forty Fund - S Shares[1,2,3] (5/97) ge-Cap Growth Funds	**1st** (31 of 687)	**1st** (57of 599)	**1st** (18 of 475)	**1st** † (1 of 207)
nus Contrarian Fund[4,5,6] (2/00) lti-Cap Core Funds	**1st** (19 of 831)	**1st** (3 of 600)	**1st** (26 of 419)	**1st** (37 of 338)
nus Core Equity Fund (6/96) ge-Cap Core Funds	**1st** (8 of 886)	**1st** (10 of 763)	**1st** (11 of 617)	**1st** (3 of 260)
nus Growth & Income Fund (5/91) ge-Cap Core Funds	**1st** (19 of 886)	**1st** (32 of 763)	**1st** (80 of 617)	**1st** † (3 of 103)
nus Orion Fund[6,7] (6/00) ti-Cap Growth Funds	**1st** (23 of 411)	**1st** (11 of 364)	**1st** (37of 285)	**2nd** (74 of 231)
nus Twenty Fund[3,‡] (4/85) ge-Cap Growth Funds	**1st** (50 of 687)	**1st** (8 of 599)	**1st** (119 of 475)	**1st** (2 of 41)

erly I Shares) ‡Closed to new investors.

ranks Janus Growth and Income Fund in the 1st quartile, 3 of 234, for the 10-year period in the Large-Cap Core Funds category.

ranks Janus Twenty Fund in the 1st quartile, 2 of 165 and 2 of 59, for the 10- and 15-year periods, respectively, in the Large-Cap Growth Funds category.

se consider the charges, risks, expenses and investment objectives carefully before investing. For a prospectus aining this and other information, please call your financial advisor or Janus or download the file on janus. . Read it carefully before you invest or send money.

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ng is for the S share class only; other classes may have different performance characteristics. †The date of the since-inception Lipper rankings is slightly different from he fund began operation since Lipper provides fund rankings as of the last day of the month or the first Thursday after fund inception.

ns have sustained significant gains due to market volatility in the health care sector.

Fund buys stock in overlooked or underappreciated companies of any size, in any sector. Overlooked and underappreciated stocks present special risks.

und held approximately 20% of its assets in Indian securities as of 9/30/05, and the Fund has experienced significant gains due, in part, to its investments in India. While gs are subject to change without notice, the Fund's returns and NAV may be affected to a large degree by fluctuations in currency exchange rates or political or economic ions in India.

und may have significant exposure to emerging markets. In general, emerging market investments have historically been subject to significant gains and/or losses. As he Fund's returns and NAV may be subject to such volatility.

ns have sustained significant gains due to investments in Brazil. As of 12/31/05, the fund held approximately 9.8% of its assets in Brazilian securities. As a result, returns NV may be affected to a large degree by fluctuations in currency exchange rates or political or economic conditions in Brazil. Holdings are subject to change without no-

nces between compared investments may include objectives, sales and management fees, liquidity, volatility, tax features and other features, which may result in differ- n performance.

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Out of the Attic, Into the Hard Drive

Scanning snapshots and slides can help preserve those memories forever. **BY LARRY ARMSTRONG**

IF YOU'RE LIKE MOST OF US, you've got your recent snapshots stored on your computer or a stack of CDs. But what about the real treasures, old family photos and slides that go back for generations? You've most likely stashed shoeboxes full of snapshots along with the negatives, disintegrating albums, and slide carousels in the attic or basement.

It's time you brought the family archives into the digital age. Why would you want to? For one thing, you can stop—or even reverse—the deterioration, restoring the vibrancy to your old color photos, or the crispness of black-and-whites. Digital prints made on modern inkjet printers will last longer without fading or changing colors than those made from film. It's easier to view the digital copies on a computer or TV th to drag out and set up a slide pr and screen. And it's cheaper t copies for family and friends (safe-deposit box).

What you'll need is a scann computer. If you set the scan the best quality and store the the uncompressed TIFF forma of which I recommend, you'll DVD burner as well. With file 50 to 100 megabytes or more f negative or slide you scan, a D hold hundreds of images, vs. or so per CD.

While you can make prett copies of snapshots on an inex all-in-one printer, which come built-in scanner, I've been loo standalone scanners. Some signed to handle film and slides deal with the multitude of pr you are likely to encounter w photos, such as faded prints, c slides, or scratches on film negati

HIGH RESOLUTION

THE TYPE OF SCANNER you nee depends on what you want to pres you have mostly old snapshots velopes or albums, but without ne your best bet is a flatbed scanner. ed models include the Canon Ca 9950F, which lists for $400, and new $550 Perfection V700 Photo. prices are usually lower.)

These flatbed scanners are d primarily for photographs and ments. But they have the high res you need for copying film and sli to 6,400 pixels per inch in the cas Epson—and they have the back li film holders you need to scan tran cies. In fact, if your slides or negat something other than 35mm film, 2.25 in. or 4 x 5 in., these scanners best for film.

If, on the other hand, you ha full of 35mm slides, or you've save negative in the envelopes th prints came in (as many people you'll get more satisfactory result dedicated film scanner. These ter a better job picking up details in t areas of a photograph. But your

Saving Old Photos

FLATBED SCANNERS such as Epson's Perfection V700 Photo ($550) are the most versatile, scanning both photo prints and batches of positive and negative film transparencies (epson.com)

FILM SCANNE such as Nikon's Co ($600) give the be individual slides or negatives, but the handle are limited (nikoncoolscan.co

ty limited. The gold standard is . $600 Coolscan V ED, which n negatives or slides at up to lots per inch. Unlike a flatbed , it won't take up much room on sk—it's less than 4 in. wide and 2 in. deep. It's also fast, scan- negative in under 40 seconds, of the 4 minutes the Epson its best settings.

ner choice is a film or slide scan- m Pacific Image Electronics, pecializes in them. I looked at the y's PowerSlide 3650, which will 899 when it comes out in May, probably sell at retail for $850 ts big advantage is you can load slides in the tray and it will scan tomatically at resolutions up to ixels per inch. The comparable etup, the Super Coolscan 5000 optional 50-slide feeder, will set k about $1,500.

reason these gizmos are so ex- is that the high-end versions ith a very powerful image en- ent package from Kodak called ICE. ICE uses software to re- ust and scratches from your film les, but requires special hard- d a second scan over the slide or to do it. The extra scan uses in- ght, looking for three-dimen- lefects such as fingerprints or of dust. The software also can he graininess you sometimes igh-speed film and restore the color when it has obviously changed.

be too aggressive when you ur prints or film; a soft cloth for ints and bulb-type air blower for e safe. Scan, and save your the highest resolution. It takes me, but that will let you print nlargements or crop and print part of the photo you want. Fi- hen you're all done, return the film or slides to the attic.

s no Saturday afternoon project. ng on how many photos you digitize, it will take weeks to dent in your treasure trove. But 've finished, you can enjoy those os as you never have before. ■

AUTO SCANNERS such as Pacific Image's PowerSlide 3650 ($780-$850) can automatically load and scan up to 50 slides (scanace.com)

Behind the Wheel of GM's Great Wide Hope

The redesigned Yukon is best-in-class. But it's defending a shrinking market. BY DAVID WELCH

WHEN GENERAL Motors decided to spend a few hundred million bucks last year to rush its redesigned large SUVs to market six months early, everyone thought company executives had to be crazy. High fuel prices had already taken a big bite out of sales. Consumers were wild for small SUVs. The fact that GM was still relying on eight-seat gas hogs to save the company seemed so old Detroit.

But when you're king of the road in a particular market, you have to defend it. So I jumped in a new GMC Yukon to see if this truck had a prayer of towing GM out of the mire. I have to say, if you're one of those buyers who still want a big brute of a truck, these large sport utes are best-in-class.

Stylistically, it doesn't look that much different than the old Yukon and its stablemate, the Chevrolet Tahoe. You have to get behind the wheel to find out what the truck is really made of. And let's make one thing clear: Though GM engineers tried their best to bend the laws of physics and make this brute drive more like a car, the Yukon is still a massive truck. Parking it in a garage or crowded lot is a neck-craning exercise in navigation.

Having said that, it's about as smooth and nimble a big SUV as you'll find. I drove the car for seven hours across Canada on a road trip. When it comes to loading up a lot of baggage and cruising for a few hundred miles, the Yukon is a comfy ride. The new front suspension lets you coast over potholes without the bone-shaking ride many competing large trucks have. For a truck this heavy (it weighs 5,000 pounds) the Yukon also takes tight turns without leaning too hard to one side. Its turning radius is pretty good, too. I had to make a quick U-turn on a four-lane road and was able to do so without having to stop, back up, and go forward again.

GMC YUKON

A better interior and a smoother ride. Still, it gets less than 20 mpg

The cabin is nicely decked out. GM finally ditched the cheap, hollow plastic knobs that belong on the dashboard of a toddler's toy car. In their place is a solid set of knobs and buttons that look like they are built with the precision of Honda or Toyota. One gripe: GMC is supposed to be GM's upscale brand, but for $38,500 I expected heated leather seats rather than cloth-wrapped benches more befitting a Chevy.

Forget about the 20 miles per gallon that GM bragged about before introducing the new Yukon. I got 15.5 mpg on my trip, albeit driving about 75 mph on the highway. I still think this is the best large SUV on the market, but its gas-hogging ways and outsize body make it a choice for SUV lovers only. ■

Aquavit, in Some Far-Out Flavors

The Nordic liquor gets an update, with tastes ranging from lingonberry to saffron. BY DAVID KILEY

YOU KNOW THINGS ARE going to get interesting when the drink menu features horseradish-infused aquavit. That's one of the offerings at Scandinavian restaurant Aquavit in New York. The place takes its name from the national drink of Sweden and may be doing as much to advance Swedish culinary expertise as Volvo has done for auto safety.

Aquavit nowadays is produced in Denmark, Finland, Germany, Norway, and Sweden, starting with alcohol from either grain or potatoes, fermented and distilled twice. When people with imagination and skill steep the odorless and colorless alcohol with fresh fruits, herbs, and botanicals, they deliver a distinctive and slightly buttery libation bursting with flavors far superior to those of mass-produced flavored vodkas. Such carefully concocted spirits are best ice-cold and can be drunk on their own or astutely matched with food at a meal.

A few commercially available aquavits are underwhelming representations of 500 years of distilling experience. The Swedish OP Anderson ($22-$25 for a 750-ml bottle) is amber, owing to aging in oak casks, and has the strong taste of caraway, anise, and fennel. From Denmark, Aalborg Jubilaeums Akvavit ($20) has a noticeable dill flavor, along with coriander and a hint of star anise. Aalborg Akvavit ($19) has the traditional distinct caraway flavor.

Aquavit restaurant owner Hakan Swahn and head chef Marcus Samuelsson, however, cross a new fjord when it comes to making the Old World spirit both in homemade stuff crafted at the restaurant and in the bottled aquavit they recently have begun to supply to liquor stores. Among the aquavits on the restaurant's menu these days are lingonberry, cucumber, raspberry-lime-ginger, orange-lemon, grapefruit-lemongrass, saffron, and pumpkin-espresso.

AT NEW YORK'S AQUAVIT Vodka infused with white cranberry (above) or orange clove

To make the aquavit that is han ed at the restaurant, Swahn star what he calls "a good shelf vodk adds flavor. Aquavit doesn't b aquavit until it's a finished flavore uct. In the case of the orange-lem vodka was allowed to steep togeth fresh fruit for three weeks to a Then the spirit was strained thr large coffee filter. The result is a cloudy fusion of citrus flavors with ton-like bits of pulp that has a sumptuous taste and long, smooth Since Swahn started with a 70-pro it, it did not have the bracing, alm dicinal shock of an 80-proof vodk as Absolut Citron ($22) or Stoli Limonnaya ($19-$24).

The variety of flav ingredients that the rant turns out in batches makes m the results with its di adventure. "Wher don't come from a producing country, get very creative wi its," says Samuelss horseradish aquav brilliant with the sampler and a better than any Riesling beer I might have The unlikely, but de pumpkin-espresso made from steeping brown-sugar-laced kin in vodka for a and adding espress in the mixture for complemented a loin with fennel, c ized ginger, celeria and apple-pine brot

You don't have t the restaurant to the new generat aquavit. Swahn tool the more popular handmade flav the bar, white cranberry, and ma first commercially available aqua duced from cranberry concentra New England, and distilled in his bottled Aquavit has a small an caraway, too, as required by the government. At $28 per bottle, New York is rolling out in major

The taste and mouth feel of the vits tilt toward liqueur, though th nearly as viscous as, say, an anise makes this new class of aquavit u delight with or without herring, a freshing alternative to factory-m vored vodkas. Skoal!

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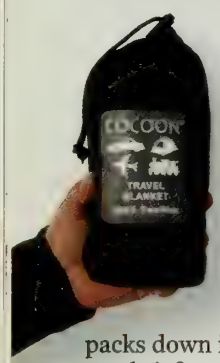
EDITED BY MONICA GAGNIER

TRAVEL

FIRST-CLASS BLANKIE, EVEN IN COACH

GIVEN THE SCARCITY of blankets on airplanes, it makes sense to bring your own. Our pick is the $30 CoolMax Travel Blanket from Cocoon (cocoonusa.com), which also happens to sell our favorite goose down travel pillow for $24. The blanket is made of a knit polyester that feels luxuriously soft and warm and moves with your body better than woven blankets. While it opens to a generous 55 inches by 70 inches, the blanket packs down in its own drawstring bag to a briefcase-friendly 3½ inches by 7 inches, the smallest on the market. You'll have space to pack a snack, something else in short supply on planes. *–Larry Armstrong*



COMMODITIES

GOING TO THE SOURCE

MOST PEOPLE KNOW the benefits of diversifying their portfolio with commodities. But did you realize that it's better to invest in the actual commodities than in the stocks of commodity producers? That's one finding of a new study by Gary Gorton of the Wharton School and K. Geert Rouwenhorst at Yale School of Management. Looking at returns since 1962, the pair found that commodity stocks had a 0.57 correlation with the Standard & Poor's 500-stock index, larger than the 0.4 correlation between the commodity stocks and commodities. When the stock market had its worst month out of 100, losing 14% on average, commodities rose more than 2%. Luckily for investors, a growing number of mutual and exchange-traded funds give direct exposure to commodity prices. So don't forget the pork bellies and crude. *–Aaron Pressman*

ANNUITIES

Follow the Index

IF YOU OWN A VARIABLE ANNUITY and you've held it long enough to avoid surre charges, consider switching to one that invests in exchange-traded funds. ET fixed baskets of securities that track a specific benchmark, such as the Dow Jo industrial average, and are among the lowest-cost investments around. So va annuities that invest in ETFs can be less pricey than traditional ones.

Integrity Life Insurance charges 0.69% to 0.77% of assets for its ETF-base annuities, plus 0.60% for fees associated with the annuity, like the mortality expense risk charge—making it cheaper than your average offering at 2.3%. players, such as Jackson National Life Insurance, have been looking at ETFs

But beware: Not all ETF-based products are cheaper than your average an MetLife, which has teamed up with brokerage A.G. Edwards for its new asset allocation product that can invest in fixed-income, stock, and real estate ETF charges 1.10% to 1.15% for the underlying assets and around 1.3% for the bell whistles of the annuity. *–Adrien*

HOT WHEELS

YOU WON'T FIND THIS ON eBAY

PINING FOR THE new Bentley Continental GTC, the convertible version of the Continental GT coupe? Then no doubt you've heard about the top speed of 195 mph, the 12-cylinder engine, and the special rear suspension. Well, there are 1,500 orders for the luxury soft top, and it could take up to nine months to get to the top of the list.

THE NEW BENTLEY

But you have a w into the fast lane: Bi first model to arrive North America. Sot will auction it off at Side House Settlem to be held at the Jac Center on Apr. 13. T includes a sneak pe New York Internati Auto Show, which o Apr. 15.

Bentley bidders c tickets to the cockta for $150, or dinner $1,000. You can also place a pho calling 248 754-4531 by Apr. 10. sticker price hasn't been announ you can bet it will be in the $100, $200,000 range. *–Chest*

Which top CEO listens to Guns N'Roses?

Who likes to eat his pancakes with salt?

Whose Dad wanted him to work in a meat packing plant rather than go to college?

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BY GENE G. MARCIAL

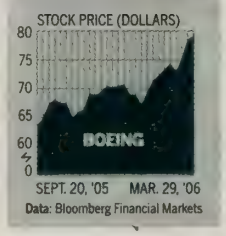
BOEING HAS GAINED ALTITUDE FAST AND COULD GAIN LOTS M

XTO IS A NATURAL PREDATOR FOR PIONEER NATURAL RESOURC

GETTING SIRIUS: SHOCK JOCK STERN REELS IN THE SUBSCRIB

Boeing: Up in the Clouds

SINCE DIVING FROM 51 IN 2003 to a three-year low of 24, Boeing (BA) has soared to 78—and the smart money says it'll keep going. "It has strong free cash flow, which will continue as it fills 2005 orders," says Standard & Poor's Jim Corridore, who upgraded the stock from "hold," to "buy," with a 12-month target of 85. (Boeing was featured in this column on Feb. 21, 2005, at 54.) Orders this year may not match 2005's, but financial results will be strong, he says. Corridore is upbeat on CEO James McNerney, who, he says, can push up debt-adjusted return on equity to 15%-17% for the next 10 years. Compounded free-cash-flow growth, he estimates, will hit 7.5% to 8.5%. And earnings before interest and taxes, he adds, should rise from 6% to over 8%. Ronald Epstein of Merrill Lynch, which has done business with Boeing, writes that "better-than-expected demand" globally for the 787 will increase deliveries in 2008 to 450 aircraft from an estimated 425 in 2007 and 405 in 2006. Output, Epstein figures, will stay at that level through 2010. The 787 "is a category killer," he says. Recently, he upped his profit estimate for 2006 from $3.35 a share to $3.40 and for 2007 from $4.20 to $4.30. The figures might be conservative, he adds. Value Line's Morton Siegel notes that the 787, slated to appear in 2008, is already nearly sold out through 2010. A bigger 787 will enter service in 2012. Siegel sees Boeing performing well for years to come.



Why Pioneer Is Prime Buyout Bait

CONSOLIDATION IN THE OIL PATCH will heat up, says Fadel Gheit of Oppenheimer. And Pioneer Natural Resources (PXD), an independent $5.1 billion oil-and-gas outfit, is one of the most attractive targets, he says. Gheit argues that Pioneer's recent sale of $1.6 billion in assets will let it focus on exploring for natural gas in North America. That would play into the strategy of XTO Energy, a $16 billion producer and an eager buyer of onshore gas in the U.S. Gheit expects XTO to go after Pioneer because of its reserves and its strong cash flow—plus its $1.6 billion hoard from selling assets in the Gulf of Mexico and Argentina. Pioneer, down from 56 in September to 43 now, is worth 60 a share based on its assets, says Gheit. Pioneer's 866 million barrels of proven reserves are valued at just $11 a barrel vs. peers' $15.50, he figures. Pioneer is "the most under-valued stock in our universe," adds Gheit. If XTO were to buy Pioneer, it would become one of the top independents, with proven reserves of 2.1 billion barrels and a market cap of $25 billion. Prudential Equities, "neutral" on Pioneer, nevertheless sees the stock at 53 in a year, based on strong demand for gas and falling production. Pioneer declined comment. XTO did not return calls.

Stern Is the Draw At Sirius Satellite Radio

IT CAN'T BE DENIED: Howard Stern is earning his Sirius Satellite Radio (SIRI). Since the talk-radio sta announced he would join Sirius, its subscriber rolls jumped to more than 4 million, with more than 1 millio additions attributable to Stern, analysts say. In the four quarter, Sirius for the first time added more subscribers rival XM Satellite Radio—and Stern is the reason, says J Lappin, president of Gramercy Capital Management, which owns shares. Sirius had trailed XM by 10 percentage points in brand recognition, and is now 10 points ahead, a phenomenal switch, says Lappin. "It's the Stern Effect," she adds. Maurice McKenzie of investment firm Friedman Billings Ramsey, who rates the stock, now at 5, "outperform" with a target of 7.50, estimates subs will hit 6 million by yearend. Stern has helped put Sirius on track to break even, or maybe turn profitable by 2007, says McKenzie. Tuna Amobi of Standard & Poor's, who Sirius a "five-star strong buy," predicts subs will hit 9.8 by yearend 2007. He sees revenues leaping to $610 mil 2006 and to nearly $1.1 billion in 2007, up from $242.3 in 2005. His 12-month price target: 8.

BusinessWeek online Gene Marcial's Inside Wall Street is p businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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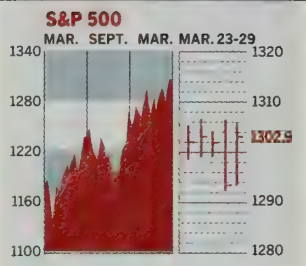
Personal Business Figures of the Week

STOCKS



COMMENTARY

The Fed's Mar. 28 rate hike—its 15th straight—took the wind out of stocks. Although the increase had been expected, traders were dismayed that there was no hint of when the central bank's work would be done. But equities made up some ground the next day. Apple and Google sent the tech-laden NASDAQ to a five-year high, while Boeing stabilized the Dow.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	MAR. 29	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1302.9	-0.2	4.4	11.8
Dow Jones Industrials	11,215.7	-0.9	4.6	7.8
NASDAQ Composite	2337.8	1.5	6.0	18.4
S&P MidCap 400	791.6	1.3	7.3	22.1
S&P SmallCap 600	393.9	1.9	12.3	24.6
DJ Wilshire 5000	13,175.6	0.3	5.4	14.8
SECTORS				
BusinessWeek 50*	777.9	1.1	4.9	13.0
BW Info Tech 100**	396.1	0.8	4.1	14.7
S&P/Citigroup Growth	613.6	-0.3	2.9	9.0
S&P/Citigroup Value	686.1	0.0	6.0	14.7
S&P Energy	409.6	3.7	9.9	24.9
S&P Financials	439.9	-1.0	3.2	16.0
S&P REIT	176.9	1.8	15.6	35.3
S&P Transportation	276.4	0.2	10.6	24.9
S&P Utilities	159.2	-0.9	-0.3	10.3
GSTI Internet	194.5	2.4	-5.2	28.4
PSE Technology	875.7	0.4	4.7	21.8

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	MAR. 29	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1657.8	-1.3	9.
London (FT-SE 100)	5959.2	-0.8	6.
Paris (CAC 40)	5180.3	-0.3	9.
Frankfurt (DAX)	5914.8	-0.3	9.
Tokyo (NIKKEI 225)	16,938.4	2.7	5.
Hong Kong (Hang Seng)	15,745.1	0.7	5.
Toronto (S&P/TSX Composite)	12,190.6	1.8	8.
Mexico City (IPC)	19,132.3	-2.4	7.

FUNDAMENTALS	MAR. 28	WEEK AGO
S&P 500 Dividend Yield	1.79%	1.78%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.9	18.0
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	15.1
First Call Earnings Revision*	0.44%	0.08%

TECHNICAL INDICATORS	MAR. 28	WEEK AGO
S&P 500 200-day average	1242.1	1239.5
Stocks above 200-day average	67.0%	66.0%
Options: Put/call ratio	0.78	0.69
Insiders: Vickers NYSE Sell/buy ratio	5.51	5.47

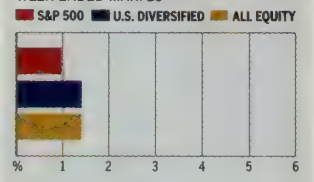
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Steel	20.5	Steel	77.5
Divsfd. Metals & Mining	14.1	Oil & Gas Equip.	72.7
Oil & Gas Refining	11.1	Oil & Gas Refining	69.2
Oil & Gas Drilling	10.0	Divsfd. Metals & Mining	66.6
Constr. Materials	9.7	Constr. & Engineering	63.3

WORST-PERFORMING GROUPS	LAST MONTH %	
Semiconductor Equip.	-5.0	Automobiles
Gas Utilities	-4.9	Broadcasting
Consumer Finance	-4.1	Home Furnishings
Indpdt. Power & Energy	-3.6	Health-Care Facilitie
Electric Utilities	-3.2	Diversified Chemical

MUTUAL FUNDS

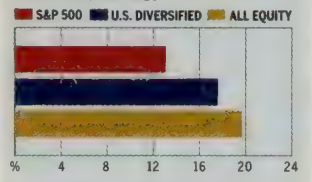
4-WEEK TOTAL RETURN

WEEK ENDED MAR. 28



52-WEEK TOTAL RETURN

WEEK ENDED MAR. 28



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Natural Resources	4.6	Latin America	74.7
Real Estate	3.8	Precious Metals	59.4
Precious Metals	3.6	Diversified Emerg. Mkts.	47.9
Communications	3.1	Natural Resources	40.9
LAGGARDS		**LAGGARDS**	
Latin America	-4.8	Domestic Hybrid	10.1
Utilities	-1.6	Large-cap Blend	13.3
Health	-1.0	Miscellaneous	13.3
Diversified Emerg. Mkts.	-0.9	Large-cap Value	13.4

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
American Heritage	12.5	ProFunds Ultra Japan Inv.	102.2
Van Wagoner Sm. Cap. Gr.	10.1	ING Russia A	88.1
U.S. Global Invrs. Gold	9.7	Midas	87.7
U.S. Glbl. Invs. Prc. Mnls.	9.3	U.S. Global Invrs. Gold	86.3
LAGGARDS		**LAGGARDS**	
Ameritor Investment	-16.7	Ameritor Investment	-68.8
iShares MSCI Brazil Idx.	-9.0	Potomac Sm. Cap/Sh. Inv.	-37.4
Allianz RCM Biotech. D	-7.0	ProFds. USh. Sm. Cap Inv.	-36.1
T. Rowe Price Emg. Europe	-5.5	American Heritage Grth.	-33.3

INTEREST RATES

KEY RATES	MAR. 29	WEEK AG
Money Market Funds	4.20%	4.09%
90-Day Treasury Bills	4.62	4.68
2-Year Treasury Notes	4.80	4.74
10-Year Treasury Notes	4.81	4.70
30-Year Treasury Bonds	4.84	4.72
30-Year Fixed Mortgage †	6.29	6.25

†Banx

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	3
General Obligations	3.96%	
Taxable Equivalent	5.66	
Insured Revenue Bonds	4.01	
Taxable Equivalent	5.73	

THE WEEK AHEAD

VEHICLE SALES *Monday, Apr. 3* » March sales of light vehicles most likely posted a narrow gain, to an annualized rate of 16.8 million, according to WardsAuto.com. In February sales slowed to a pace of 16.6 million units.

PURCHASING MANAGERS' INDEX *Monday, Apr. 3, 10 a.m. EDT* » The Institute for Supply Management's March factory activity index is forecast to have come in at 57%. That's the median forecast among economists surveyed by Action Economics. In February the index rose to 56.7%.

CONSTRUCTION SPENDING *Monday, Apr. 3, 10 a.m. EDT* » Building outlays probably improved by 0.4% in February, following a 0.2% increase during January.

EMPLOYMENT *Friday, Apr. 7, 8:30 a.m. EDT* » Nonfarm payrolls in March most likely rose by 200,000 workers, after the economy added 243,000 jobs in February. The unemployment rate is expected to remain at 4.8%. Average weekly wages probably rose 0.2%, after growing 0.3% in the prior month.

INSTALLMENT CREDIT *Friday, Apr. 7, 3 p.m. EDT* » Consumers most likely assumed an additional $3.9 billion of debt in February, the same amount by which installment credit grew during January.

The *BusinessWeek* product was virtually unchanged at the week ended Mar. 18, from a year ago. Before calc the four-week moving ave index held at 269.1.

BusinessWeek

For the BW50, more inves data, and the component of the production index vi www.businessweek.com/extras

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Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

ACC Capital Holdings **42**
Advanced Cell Technology (ACTC) **52**
Advanced Micro Devices (AMD) **58**
A.G. Edwards (AGE) **102**
Alcatel (ALA) **28**
AlixPartners **62**
Alliance Capital (AC) **89**
Anadarko Petroleum (APC) **89**
AOL (TWX) **37**
Apple (AAPL) **20, 82**
Aquavit **100**
area/code **22**
AshBritt **38**

B

Bain Capital **30**
Baird & Warner **75**
Bank of America (BAC) **18, 37**
Barclays (BCS) **42**
Bayer (BAY) **28**
BEA Systems (BEAS) **66**
Bertelsmann **28**
Bethlehem Steel **62**
Biovail (BVF) **50, 52**
Blackstone Group **30**
BMW **114**
Boeing (BA) **104**
Borders Group (BGP) **79**
Boston Consulting **58**
Boston Red Sox **42**
BSkyB (BSY) **64**
Burger King **30**
Burlington Northern (BNI) **96**
Burrill **52**

C

Cafaro **60**
Campbell Soup (CPB) **16**
Canon (CAJ) **82, 98**
Capital One (COF) **37**
Caterpillar (CAT) **96**
CB Richard Ellis (CBG) **68**
CBS (CBS) **50, 64**
Cendant (CD) **75**
Center for Financial Research **50**
Century 21 (CD) **75**
Chicago Asset Management **30**
Chipotle Mexican Grill (CMG) **30**
Chiron (CHIR) **52**
Citigroup (C) **18, 58**
Coca-Cola (KO) **58**
Coldwell Banker (CD) **68, 75**
Collins & Aikman (CKC) **62**
Continental (CAL) **30**
Convergys (CVG) **48**
Cornell Capital **52**
Credit Suisse (CSR) **42**

D

DaimlerChrysler (DCX) **62**
Dana **62**
Datamonitor **16**
Dean Foods (DF) **39**
Dell (DELL) **82**
Delphi (DPHIQ) **28, 62**
Deutsche Bank (DB) **60**
Deutsche UFG **44**
Diageo (DEO) **30**
DirecTV (DTV) **22**
Dubai Ports World **28, 42**
Duke Energy (DUK) **42**
DuPont (DD) **80**

E

Eastman Kodak (EK) **98**
eBay (EBAY) **16, 28, 37, 64**
Edina Realty **75**
Enron **50**
Epson **98**
ExxonMobil (XOM) **44, 96**

F

Facebook **13**
First American Real Estate Securities Fund (FREAX) **94**
First Potomac Realty Trust (FPO) **94**
Flinker **52**
Ford (F) **38, 62, 114**
Foxtons Realty **75**
Franklin Resources (BEN) **89**
Friedman Billings Ramsey (FBR) **104**

G

Gartner **36**
Gazprom **44**
Genentech (DNA) **52**
General Electric (GE) **58**
General Motors (GM) **13, 28, 34, 62, 99, 114**
Global Insight **68**
GMAC (GM) **28, 62**
Goldman Sachs (GS) **25, 28, 30, 42**
Google (GOOG) **16, 28, 36, 64, 79**
Gradient Analytics **50**
Gramercy Capital **104**
Growth Fund of America (AGTHX) **88**

H

Harley-Davidson (HDI) **110**
HarperCollins (NWS) **79**
Hartford Financial (HIG) **18**
Hedge Fund Research **50**
Heidrick & Struggles (HSII) **58**
Hemphill Construction **38**
Hershey (HSY) **58**
Hewlett-Packard (HPQ) **82, 112**
Hilton Hotels (HLT) **94**
Honda (HMC) **99, 114**
House Values (SOLD) **75**
HSBC (HBC) **80**
Humana (HUM) **58**

I

IAC/InterActiveCorp (IACI) **75**
IBM (IBM) **66, 80, 82**
Iconoculture **14**
IKBI **38**
Ingram Industries **79**
InPhonic (INF
Integrity Life I **102**
Iowa Realty **7**

J

Jackson Natio Insurance (F
Janus (JANS)
JBoss **66**
Johnson & Jo (JNJ) **80**
JPMorgan Ch **42**
Julius Baer Internationa Fund (BJBIX

K

Kaspersky La
Kellogg (K) **5**
Kite Realty (K
Koenigsegg **1**
Kohlberg Kra **30**

(KFY) 58
(KFT) 16,
me (KKD) 50
sociates 50

senberg
nal Small
(RISIX) 88
n (LM) 88,

e (IACI) 75
N) 68
ics 82
ource 79
nds (LTO)

MSFT) 36
ne (LIZ) 80
) 28, 112
OY) 44

ecords 64

Matrix Partners 66
Maytag (MYG) 28
McDonald's (MCD) 30
McGraw-Hill (MHP) 28, 88
McKinsey 114
Merck (AG) 28
Merrill Lynch (MER) 104
MetLife (MET) 102
Microsoft (MSFT) 20, 36, 64, 66
Miller Samuel 68
Morgan Stanley (MS) 34, 42, 44
Motorola (MOT) 112
MphasiS BFL 48
MySpace.com (NWS) 37

N

Napster (NAPS) 64
National City (NCC) 68
NBC 64
Newell Rubbermaid (NWL) 58
New England Patriots 42
Nielsen//NetRatings 64
Nike (NKE) 64
Nikon 98
Nissan (NSANY) 80
Noble Energy (NBL) 89
Nokia (NOK) 22
Nordstrom (JWN) 68
Norfolk Southern (NSC) 96
Novartis (NVS) 52
Novavax (NVAX) 52
Novell (NOVL) 66
NPD Group 60

O

Obeetee 18
Opinion Research (ORCI) 48
Oppenheimer (OPY) 94, 104
Oracle (ORCL) 66
Overstock.com (OSTK) 50
Oxford Bioscience 52
Oxford Health Plans 30

P

Pacific Image Electronics 98
Panasonic (MC) 82
P&O 42
PayPal (EBAY) 16, 64
Penn Virginia (PVA) 96
PepsiCo (PEP) 16, 18
Philips Electronics (PHG) 82
Phillips & Jordan 38
Pioneer Natural Resources (PXD) 104
Piper Jaffray (PJC) 36
Procter & Gamble (PG) 58, 110
Prudential Equity 104
PSA Peugeot Citroën (PEUGY) 10
Punk Ziegel 68

Q

Qwest (Q) 22

R

Random House 79
RealEstate.com (IACI) 75
Realty Legacy 75
Redfin 75
Red Hat (RHAT) 66
Retail Consulting Services 60
Risk Management 14
Rochdale Securities 34
Rocker Partners 50
Rockwell (ROK) 78
Roku 20
Rosneft 44

S

SAC Capital Advisors 34, 50
Safeway (SWY) 80
Sana Security 37
Schering 28
S.C. Johnson & Son 58
Seagate Technology (STX) 30
Secure Systems 37
Sequoia Capital 64
Sirius Satellite (SIRI) 104
Sony (SNE) 82
Sony BMG Music 28
Sotheby's (BID) 102
Southwest Airlines (LUV) 110
Spencer Stuart 58
Standard & Poor's (MHP) 28, 34, 76, 104
Staples (SPLS) 80
Starbucks (SBUX) 80
Steve & Barry's 60
Stratton Growth Fund (STRGX) 88, 96
Sun (SUNW) 66
Symantec (SYMC) 37

T

Target (TGT) 60
TerraPass 80
Texas Pacific 30
3 PhasesEnergy Services 80
Tiffany (TIF) 13
Time Warner (TWX) 34
Tim Hortons (THI) 30
TNS Media Intelligence 30
Tome on the Range 79
Torto Wheaton (CBG) 68
Tower Automotive (TWRAQ) 62
Toyota (TM) 99
Tyco (TYC) 50, 112

U

UBS (UBS) 44
U.S. Steel (X) 62

V

ValueAct Capital Partners 52
Value Line (VALU) 104
Viacom (VIA) 13
Vical (VICL) 52
VirusTotal 37
VIZ Media 14
Volkswagen 80

W

Wal-Mart (WMT) 39, 60
Washington Post (WPO) 79
WD Partners 30
Wendy's (WEN) 30
Whirlpool (WHR) (WHR) 28
Whole Foods Market (WFMI) 80
Wm. Wrigley Jr. (WWW) 58
Wyeth (WYE) 18

X

XM Satellite Radio (XMSR) 104
XTO Energy (XTO) 104

Y

Yahoo! (YHOO) 36, 64, 79
Yankee Candle (YCC) 58
YouOS 36
YouTube 64
Yukos 44

Z

Zillow.com 75

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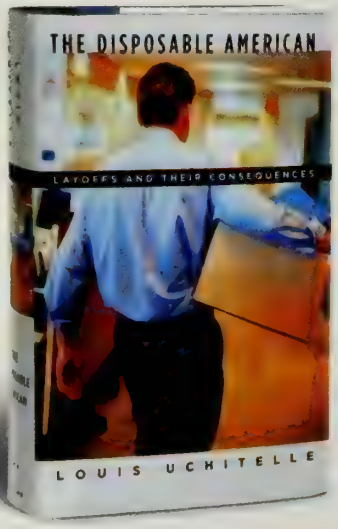
The Shortsighted Solution

THE DISPOSABLE AMERICAN Layoffs and Their Consequences
By Louis Uchitelle; Knopf; 283pp; $25.95

Some economists call it the hedonic treadmill: The way many Americans work (all the time) and live (in an arms race for status) conspires against the happiness they say they crave. We're the richest, most powerful country in the world. But an increasing amount of hard data shows that as our ability to own homes and cars and TVs has increased, so have our rates of addiction, depression, and economic inequality. These findings are causing some economists and policymakers, including *New York Times* economics reporter Louis Uchitelle, to raise questions about whether we've sacrificed too much for growth. After all, if we're not achieving the greatest happiness for the greatest number, why, asks Uchitelle in his important new book, *The Disposable American*, does the pursuit of growth still rule economic ideology?



Fundamentally, Uchitelle's book is about what he views as the folly of the modern layoff—one of the inevitable results of an economy designed for nonstop expansion. Uchitelle draws upon mounds of research to show that slashing staff in the name of growth does not, in the long run, lead to better stock performance. Yet CEOs, their thinking warped by Wall Street-induced short-term-itis, continue to hack away. The more anorexic their payrolls, the more obese the CEOs' pay packages. This culture, in which employees are treated as if they have sell-by dates, Uchitelle says, has huge, oft-ignored costs, and he rails against the idea that there's no alternative to reduction in forces. He describes the problems, especially the psychological fallout, so well that one yearns for more innovative solutions. But his prescriptions differ little from those backed by progressives since at least the 1930s. Still, the logic with which he lays waste to commonly accepted layoff rationalizations is airtight.

Rationalization No. 1: Layoffs save money. What that equation misses, says Uchitelle, are hidden costs that include severance, potential lawsuits from aggrieved workers, loss of institutional memory and trust in management, a shortage of staff when the economy rebounds, rehiring expenses, and a culture of survivors who are risk-averse, paranoid, and alienated. Contrast that with the evidence Uchitelle marshals to argue for a no-layoff payoff: fierce loyalty, higher productivity, and superior innovation at such companies as Southwest Airlines and Harley-Davidson.

Rationalization No. 2: So what if the labor market i game of musical chairs where workers routinely get b There are lots of good jobs, at least for the college-edu Uchitelle's opinion, shared by a growing group of eco is that, to the contrary, there just aren't enough well-p jobs with decent benefits to meet demand. Today's lo figures miss all the people who are "bought out" but exiled, who are "free agents" but really traded back a in the global discount labor bazaar. One of *The Dispos American*'s most poignant anecdotes involves a 47-ye executive who, after 25 years with Procter & Gamble, her $150,000 a year job in a buyout. Then, when one cheaper young staffers hired to replace falters, she is rehired as a "consultant" per hour for three to five hours a week. also the laid-off sixtysomething who strenuously works his alumni network net zero job offers, even though he has from Harvard and Wharton. His depres conclusion? His education hurt him by him up for expectations that he can nev

Many say that, in the end, layoffs wil about a reenergized, dynamic U.S. econ one that will eventually lead to another equilibrium. In contrast, Uchitelle argu the rampant income volatility produce layoff-happy business culture is creatin society of downwardly mobile, insecure workers. The problem is that today's so infrastructure was built for the Compa not for the you're-on-your-own free ag this great risk shift, bu once shared within soc being transferred onto employees' shoulders.

Layoff mania is creating a society of insecure, downwardly mobile people

That's why Uchitelle that America needs a n safety net. His fixes incl passel of liberal reform progressive income tax government jobs progr increase in the minimu laws requiring severan packages, and stronger regulations. He knows many will balk at these shopworn ideas. But instead on logic to make his case, he appeals to Americans' s well-being: People who live in societies where these are a given, he correctly reports, say that they are mo content. Similar results are reported by those who fe work is stable. With such realities, Uchitelle says, lay should be the last place CEOs turn—not the first. ■

–By Miche

he BusinessWeek Best-Seller List

RDCOVER BUSINESS BOOKS	LAST WEEK	MONTHS ON LIST
WORLD IS FLAT Thomas L. Friedman (Farrar, Straus iroux • $27.50) *Globalization is great—sort of, says a umnist from* The New York Times.	1	10
AKONOMICS Steven D. Levitt, Stephen J. Dubner orrow • $25.95) *Crack gangs, the Ku Klux Klan, and re, examined by a University of Chicago economist.*	2	11
NK Malcolm Gladwell (Little, Brown • $25.95) *Why p judgments deserve careful consideration.*	3	14
CRAMER'S REAL MONEY James J. Cramer (Simon chuster • $26) *Trading recommendations from CNBC commentator.*	6	11
LITTLE BOOK THAT BEATS THE MARKET Joel Greenblatt ley • $19.95) *The basics of "value investing."*	5	3
NUMBER Lee Eisenberg (Free Press • $26) *A meditation etirement and second acts, by the former editor-in-chief* squire.	4	2
LITTLE RED BOOK OF SELLING Jeffrey Gitomer rd Press • $19.95) *A columnist on why people buy.*	7	18
TOTAL MONEY MAKEOVER Dave Ramsey (Thomas Nelson• .99) *Getting rid of debt and building up your rainy-day erves.*	9	15
WAL-MART EFFECT Charles Fishman (Penguin Press • .95) *The retailer's single-minded focus on price-cutting is d for some, disastrous for others.*	—	1
RETS OF THE MILLIONAIRE MIND T. Harv Eker rperBusiness • $19.95) *Shape your financial destiny.*	—	11
FRED FACTOR Mark Sanborn (Currency/Doubleday • .95) *The mailman's philosophy of work and life.*	13	15
ONE MINUTE MANAGER Kenneth Blanchard, PhD, Spencer nson, M.D. (Morrow • $19.95) *Three management niques, conveyed in brief story form.*	—	11
MILLIONAIRE MAKER Loral Langemeier (McGraw-Hill • .95) *Bet the ranch, says this single mom and seminar ler.*	—	1
NING Jack Welch with Suzy Welch (HarperBusiness • .95) *How to succeed within a company, against your petition, and over the course of a career.*	10	11
COMING ECONOMIC COLLAPSE Stephen Leeb, PhD, with n Strathy (Warner • $24.95) *You can get rich from the ning oil shortfall.*	—	1

PAPERBACK BUSINESS BOOKS	LAST WEEK	MONTHS ON LIST
1 **GOOD TO GREAT AND THE SOCIAL SECTORS** Jim Collins (Collins • $11.95) *How noncorporate organizations can excel.*	15	3
2 **GETTING THINGS DONE** David Allen (Penguin • $15) *Organizing your office and learning how to manage your time.*	1	23
3 **COLLAPSE** Jared Diamond (Penguin • $17) *From Easter Island to Central America, why civilizations fall apart.*	—	1
4 **THE AUTOMATIC MILLIONAIRE** David Bach (Broadway • $12.95) *How you can put your investment program on autopilot.*	2	2
5 **J.K. LASSER'S YOUR INCOME TAX 2006** The J.K. Lasser Institute (Wiley • $16.95) *Sharpen your pencils, and...*	3	3
6 **CONSPIRACY OF FOOLS** Kurt Eichenwald (Broadway • $16.95) *Inside Enron's crumbling house of cards, by an investigative reporter from* The New York Times.	6	2
7 **THE ERNST & YOUNG TAX GUIDE 2006** Ernst & Young, LLP (CDS Books • $16.95) *...get out the calculator.*	4	3
8 **WHAT COLOR IS YOUR PARACHUTE?** Richard Nelson Bolles (Ten Speed Press • $17.95) *The 2006 edition of the enduring job-search bible.*	5	3
9 **THE WALL STREET JOURNAL COMPLETE MONEY & INVESTING GUIDEBOOK** Dave Kansas (Three Rivers Press • $14.95) *From balance sheets to a business vocabulary.*	7	2
10 **PAY IT DOWN!** Jean Chatzky (Penguin • $12.95) *The Today Show's financial editor on dumping your debts*	—	1
11 **FIND IT, FIX IT, FLIP IT!** Michael Corbett (Penguin • $15) *Profiting from real estate, by a television-show host.*	—	1
12 **TOTAL MONEY MAKEOVER WORKBOOK** Dave Ramsey (Thomas Nelson • $17.99) *Give your finances a workout and whip them into shape.*	9	14
13 **RICH DAD'S BEFORE YOU QUIT YOUR JOB** Robert T. Kiyosaki with Sharon L. Lechter, CPA (Warner • $16.95) *Starting your own business.*	—	4
14 **THINK AND GROW RICH** Napoleon Hill (Ballantine • $7.99) *Willpower and a positive attitude are the keys to achieving wealth.*	—	11
15 **INVESTING FOR DUMMIES** Eric Tyson, MBA (Wiley • $21.99) *The fundamentals of real estate, the stock market, small business, and so forth.*	12	12

RUNNING BEST-SELLERS

R BUSINESS BOOKS

REAT Jim Collins (HarperBusiness • $27.50)

OVER YOUR STRENGTHS Marcus Buckingham, Clifton (Free Press • $27)

YSFUNCTIONS OF A TEAM Patrick Lencioni s • $22.95)

D MY CHEESE? Spencer Johnson (Putnam • $19.95)

I Larry Bossidy, Ram Charan (Crown Business • $27.50)

en C. Lundin, Harry Paul, John Christensen $19.95)

THE 21 IRREFUTABLE LAWS OF LEADERSHIP John C. Maxwell (Thomas Nelson • $22.99)

RAVING FANS Ken Blanchard, Sheldon Bowles (Morrow • $20)

FIRST, BREAK ALL THE RULES Marcus Buckingham, Curt Coffman (Simon & Schuster • $27)

PAPERBACK BUSINESS BOOKS

THE TIPPING POINT Malcolm Gladwell (Back Bay • $14.95)

RICH DAD, POOR DAD Robert T. Kiyosaki with Sharon L. Lechter (Warner • $16.95)

THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE Stephen R. Covey (Free Press • $15)

THE E-MYTH REVISITED Michael E. Gerber (HarperBusiness • $16)

GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • $15)

THE RICHEST MAN IN BABYLON George S. Clason (Signet • $6.99)

RICH DAD'S CASHFLOW QUADRANT Robert T. Kiyosaki, with Sharon L. Lechter (Warner • $17.95)

SMART WOMEN FINISH RICH David Bach (Broadway • $14.95)

Veek's Best-Seller List is based on a survey of chain and independent booksellers that carry a broad selection of books on economics, management, marketing, small business, investing, personal finance, and careers. Well over 1,000 retail outlets nationwide are represented. Current rankings are based ted analysis of unit sales in February.

nd more are available on **AOL** (Keyword: BW) or **www.businessweek.com**

Ideas The Welch Way

BY JACK AND SUZY WELCH

Paying Big-Time for Failure

What do you think about the obscene severance packages being handed out to CEOs who have basically failed on the job? As a (small) stockholder and a middle manager who busts his butt for five figures, that drives me crazy.

–Anonymous, Miami

You're not alone, but just make sure you aim your anger in the right direction—and that might not be at the CEOs getting the huge payouts. All they did was say: "Yes, thank you," when offered a big package. Greedy? Maybe. But more often, they are simply the beneficiaries of a common and disturbing dynamic that starts in the boardroom.

Which brings us to the real culprits here, the company directors. They're behind many severance pay debacles for one main reason: They messed up succession planning.

Why does succession planning have so much to do with severance pay? Because many of the "obscene" payout deals that bother you so much weren't created when the errant CEO was fired. They were designed long before, when the new boss was hired from the outside because the board failed, over several years, to develop a pool of internal talent.

Not that internally promoted CEOs come cheap. The typical insider will get a substantial pay increase, hefty rewards tied to performance, plenty of new perks, and a bigger office. But the deal gets much richer when a white knight has to be enticed to gallop in and save the company from itself. These saviors on horseback get everything an insider gets, plus the guarantee of a big consolation prize even if they blow it. And that last part is usually why the deal gets sealed. Without back-end protection, no outsider would touch most of these risky positions.

> Who is really to blame for those fat severance packages given to CEOs who falter?

Not all severance messes are related to outsider CEOs, of course. Sometimes insider CEOs fail and get sent on their way with more money than they appear to deserve. That can be galling, too, but the dynamic we're talking about is different. It starts when a board needs a new CEO and, looking inward, realizes: "Oops! We forgot to plan for that." The directors then call in a headhunter, whose lust for a successful placement is second only to the board's level of panic. The dynamic is complete when a seemingly perfect candidate is located—usually in a wonderful, secure job that he or she has no intention of leaving. Unless, of course, the deal is r

Case in point: Hewlett-Packard. Back in 1999, whe board decided to change CEOs, the lack of internal ca launched headhunters into a national search. Soon en they found Carly Fiorina, successfully toiling away at Technologies. Amid great fanfare, she was pried away her comfortable position with, needless to say, an offe couldn't refuse.

But Carly's six-year tenure at HP was fraught with h dissension. So you would think that when she was fire farewell gift would be modest. At about $40 million, i wasn't—sparking widespread criticism, much of it air Carly. But what about HP's board? Without doubt, it negotiated the severance payout, and it did so as Carly prancing in with trumpets blaring, not as the door wa slamming behind her.

The HP case is hardly unique, although sometimes endings are happier. Take Ed Breen and Tyco. In 200 was hit by a disastrous accounting scandal, and its CE removed. Again, the board turned to headhunters, wh quickly set their sights on Ed, a respected executive at Motorola. But Ed wasn't going to quit a thriving caree unsullied company to clean up the chaos at Tyco for a standard-issue deal. No wonder the board had to back Brink's truck to unload a new compensation package doorstep. Fortunately, Ed is doing a good job at Tyco, terms of his severance package are a moot point.

Look, we agree that severance packages can be obs But unfortunately, this problem is probably going to g worse. The reason: Sarbanes-Oxley has driven scores boards into a state of frenzied micromanagement. To of them are now more concerned with accounting mi than with people development, including succession planning. What a shame. Boards have only one job m important than developing internal candidates: coach supporting the current CEO. Boards can't do the work management. They can only make sure the right management is in place, now and in the future.

So we're with you on this one and don't blame you wanting to scream. The big severance packages awar failed leaders make you question the whole capitalisti system. But should you ever decide to really let it rip, make sure, if the CEO was an outside recruit, that you your invective not at the easy target, but at the right o

---

Jack and Suzy Welch are co-authors of the best-seller Winni *(HarperCollins 2005). They look forward to answering you questions about business, company, or career challenges. Please e-mail them at* **thewelchway@businessweek.com**

"If you see money in your code, you want to protect it. If you don't, then you want it liberated."

– Dana Blankenhorn, ZDNet Open Source Blog

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IdeasOutside Shot

BY TOM DASCHLE

Health Reform: Good Busine

The biggest frustration during my 26 years in Congress was our failure address the health cost crisis. Ideological differences certainly made progress difficult. But more destructive were the mixed messages comi from the business community. Even as business leaders at home insiste that the current system was unsustainable, their lobbyists in Washingt

often blocked change. That gap must be bridged because Congress can make our health system more efficient and equitable only if the power of business is brought to bear.

You need only look at the auto industry for proof that our health-care system is broken. Ford and General Motors pay nearly $1,500 in health-care costs for each vehicle they produce, while BMW pays $450 per car in Germany and Honda $150 in Japan. Unfortunately, every American company faces a similar burden. The Bush Administration reported that U.S. health spending hit a record 16% of gross domestic product in 2004, when businesses spent $448.3 billion on health benefits.

Detroit's continuing market-share declines show how these costs hurt competitiveness. But hefty health-care bills also affect jobs and profits. One in five employers expects to slow hiring in 2006 because of health costs. And health costs are likely to exceed profits at the largest corporations by 2008, according to a McKinsey & Co. analysis.

Relief requires major reform in the way we buy and finance health insurance, making care accessible and affordable to all. But reform will come only when business leaders recognize they have the most to lose from the current system and the most to gain from broad reforms. Unfortunately, so far we have seen a failure of leadership in both our nation's capital and its boardrooms in crafting a solution.

Beltway-based business lobbying groups have fought major reform based on two claims. The first is that government cannot do as well as private industry leaders in addressing the crisis. True, some companies succeed in providing workers with high-quality care at a reasonable price. But that's the exception. More often, small and rural businesses are unable to negotiate reasonable insurance rates, while large companies with aging, less healthy workers face ever-rising premiums. Meanwhile, a handful of large insurers and hospital systems have gained control of the market, reducing competition. The bottom line: Most employers face structural challenges that don't permit them to contain

The second claim is that the "cure will be worse tha disease" because Washington will increase regulation costs to businesses. This does occasionally occur, but it almost certainly happen if businesses sit on the sidelin Indeed, by spending nearly half a trillion dollars a year health benefits, business has earned a seat at the table the system—it just needs to take it. Here are three way

First, business can help banish the myths that block reform. Too many Americans believe they have the bes system on the globe. But the World Health Organizatio actually ranks the U.S. 37th in world health system performance. No smart investor would ac such disappointing performance.

> So far, corporate lobbyists have fought major reform based on two false claims

Second, business leaders can bring rea experience in areas like disease preventio achieving economies of scale, and expanc coverage to boost productivity and reduc Such proven solutions, rather than Presic George W. Bush's "consumer-directed he care," should be the basis for real reform.

Third, business leaders themselves car demand that Washington make health re top priority. Despite their own enormous costs, leading corporations outsource to Washington-based business associations of representing them in this area. These advocate little real change, since they mu the lowest common denominator among their membe small businesses have different priorities than large businesses, as do those in different industries and regi those who benefit from the status quo, even if in the m tend to prevail.

That must change. American businesses, like Amer families, are suffering from today's health cost crisis. time for business leaders, in the best interest of emplo shareholders, and the country, to pave the way for acti

Tom Daschle, former *Senate Minority Leader (D-S.D.), Distinguished Senior Fellow at the Center for American and special adviser at Alston & Bird* LLP.

Views expressed in Outside Shot are solely those of contributors.

ss Week
April 17

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Blue Chip Blues

ny America's biggest cks have lost their zle–and how they ght get it back

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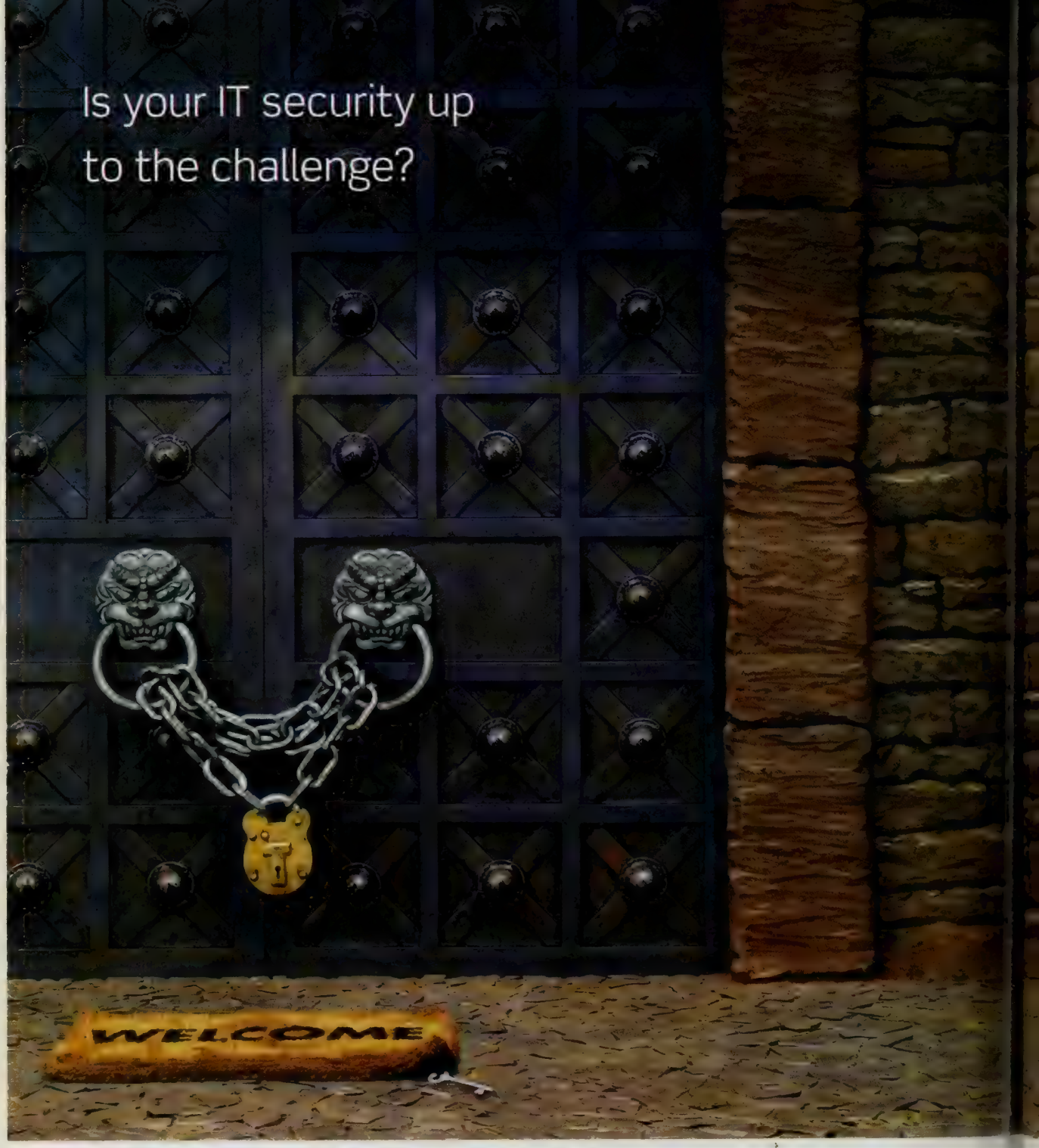
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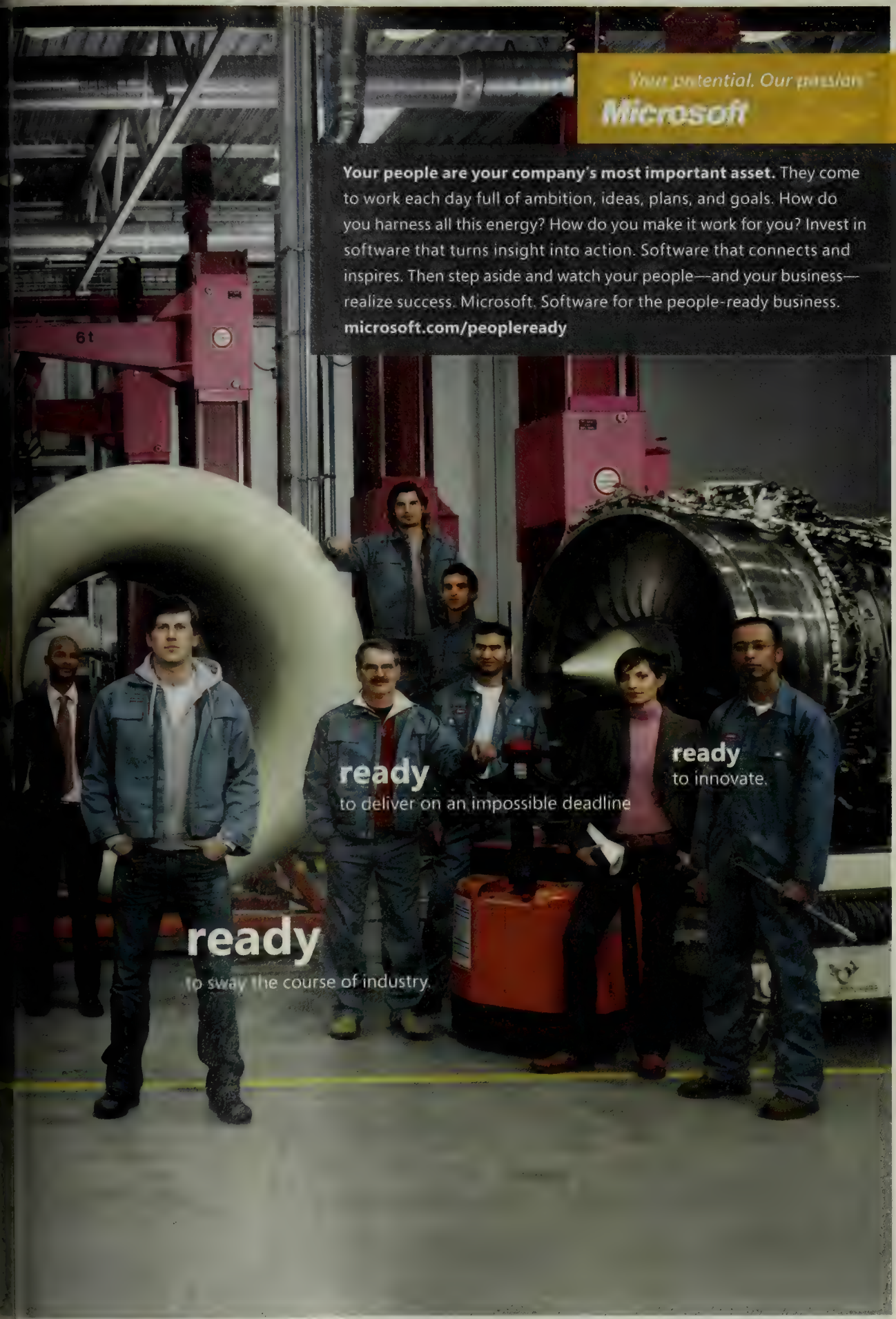

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BusinessWeek

April 17, 2006

66
WHAT'S GOING ON?
Blue chip stocks are stuck in the doldrums. One reason: Investors now have so many other intriguing options

30
PARTISAN SHOPPING
Now there are blue and red consumers

80
EXIT RAMP
Talented execs are fleeing Detroit

Cover Story

66 Blue Chip Blues
U.S. corporate giants ar turning in strong profits but their stocks remain weaklings on Wall Stree Indeed, in the past five years the S&P 100 has struggled to reach its pr slump level. Here's why America's biggest stock have lost their sizzle—a how they can get it bacl

74 GE: When Execs Outperform the
Jeff Immelt must convince the troc that the market will reward their e

The Business Week

28 News You Need To Know
Alcatel and Lucent; Apple does Windows; GMAC; Delphi's labor v

News: Analysis & Commentary

30 The Ideological Consumer
A new challenge for business: Mo people are putting their money wh their politics are

34 If You're Cheating on Your Taxe
States and the IRS are turning to c mining software to turn up scoffla

36 A New Bird Flu Warning
Because of asbestos-related lawsu protective masks may be in short

40 EBay's Bid for Impatient Shopp
EBay Express lets buyers pay fixed

42 Kick out the Kids, Bring in the S
As malls ban unchaperoned teens 5 p.m., shoppers return

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d Games Cybercrooks Play
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pany's fans don't mind paying
um for its fresh breads and
alternative fast food

rtainment

ion: Precarious at Paramount
dio chief Brad Grey stay in the
A big fat hit movie couldn't hurt

92
FIT FOR SUCCESS
Trading golf wear for business suits, these former pros have found new ways to profit from their knowhow

Finance

76 The Profit Picture Could Get Uglier
Analysts' estimates have been lowered, but the numbers may drop more

Workplace

80 Burning Rubber out of Motor City
Executives exit GM and Ford as industry troubles take a toll on management

Scandals

82 A Scratch on Hyundai's Paint Job
A political scandal raises questions about Hyundai Chairman Chung's sweet deal with an affiliate

People

84 PR's Stealth Fighter
When there's a crisis to manage or a foe to discredit, Eric Dezenhall doesn't pussyfoot around

86 Silicon Valley Confidential
How valleywag.com's Nick Douglas became tech's gossip hound

Marketing

88 Learning to Love TiVo
Mad Ave. tries to embrace the bane of television commercials

Golf & The Business Life

92 Beyond the Links
Meet five erstwhile tour pros who have managed to reinvent themselves as successful entrepreneurs

Columnists

22 Wildstrom: Technology & You
Why switching to HDTV ain't easy

24 Fine: Media Centric
Communing with the dinosaurs at the annual conference of the Newspaper Association of America

25 Cooper: Business Outlook
It's way too early to count consumers out of the spending game

103 Marcial: Inside Wall Street

110 Bartiromo: Face Time
Bill Clinton talks about his global initiatives and globalization

Ideas

108 Books
Lamster: *Spalding's World Tour: The Epic Adventure That Took Baseball Around the Globe—and Made It America's Game*

112 Outside Shot: Don Moore
SarbOx is just a start. Further rules are needed to help keep auditors impartial

Voices of Innovation

20 The Plane Genius of Walt Gillette
Meet the creative force behind the upcoming 787 Dreamliner—and every other Boeing jet since the mid-'70s

Features

11 UpFront
16 Readers Report
19 Corrections & Clarifications
104 Figures of the Week
107 Index of Companies

THE WALL STREET JOURNAL.

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What's Hot This Week A

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Computer fraudsters are devising new ways to dig up your sensitive information: They're getting inside your head. According to Brian Grow's story on page 54, psychological cunning, as much as technological knowhow, helps cybercriminals pickpocket personal identities—a subject furt illuminated by our online special report. To find out more, we asked online reporter Sarah Lacy to spend a day at **a bootcamp for "ethical" hackers.** She shares how easy it is to craft the code that wreaks havoc on the world's computer networks. Of course, why go after individuals when you can really score big by **cracking a bank?** Thwarted by big banks, identity thieves are stepping up attacks on less fortified midsize financial institutions. We profile a credit union in Washington that provides a model for fighting back. And no that you've splashed out on a brand new personal computer, you'll want to keep it safe. Our **guide to PC Security** gear shows how. Finally, attorney Christopher Wolf makes his case for a federal privacy and data security law in place of the existing thicket of confusing and conflicting state regulations. You'll f all this and more at **www.businessweek.com/go/computersecurity**

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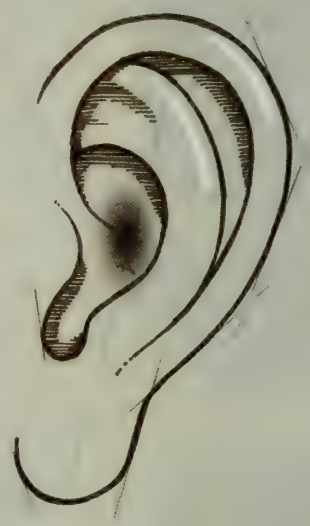

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UP Front

"I do not believe that companies wake up in the morning just being altruistic."

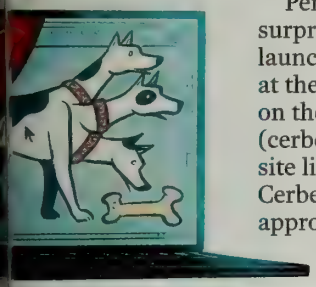
–Wal-Mart CEO Lee Scott on the company's new plan to move into distressed areas and help local businesses, in part to help win community support, as reported by Reuters

BY DEBORAH STEAD

ET SECRETS

BERUS: GREAT EILING

S Capital nent and its c boss, 46-year-old A. Feinberg, have



viewed as perhaps secretive folks on et (BW—Oct. 3). But the private nt firm—named for headed dog in thology who guards to Hades—emerged from the shadows. For starters, it led a consortium of investors, including Citigroup, in a highly publicized transaction: agreeing to buy a majority stake in **General Motors Acceptance Corp.**, the financing arm of troubled American icon **General Motors**.

Perhaps even more surprising, Cerberus launched its own Web site at the stroke of midnight on the same day (cerberuscapital.com). The site lists the companies in Cerberus' portfolio—names, approximate number ("more than 40"), and their combined revenues ($45 billion). It also displays an organization chart and names 47 of the firm's executives, including its global chairman, former Vice-President Dan Quayle.

–Emily Thornton

BIG PICTURE

OUT THE CANDLES Biotech giant etech (DNA) and tech star Apple Computer) both turn 30 this year. iPods may get the ut lately Genentech has had bigger returns on reet, thanks to its hit cancer drug Avastin.

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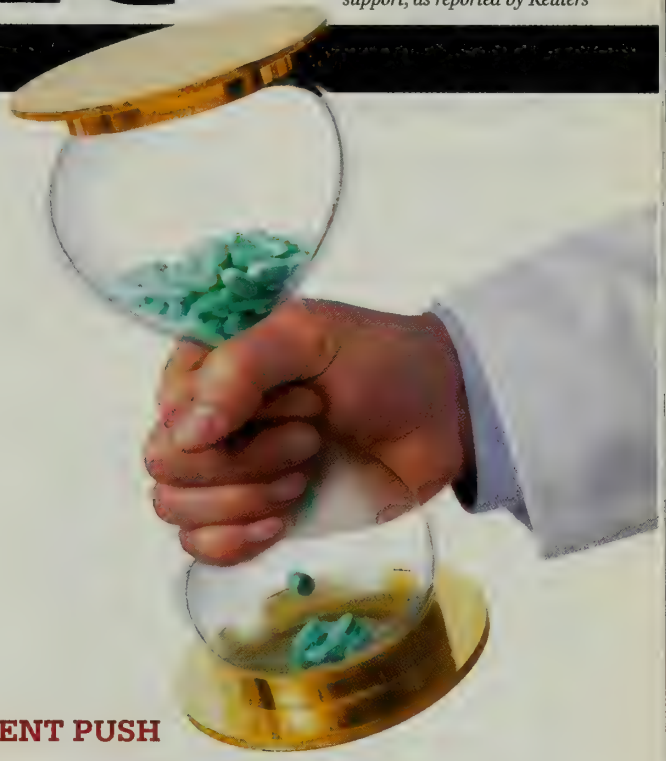

PATENT PUSH

Big Pharma Wants More Time

EXPECT A NEW skirmish between Big Pharma and the generics. Some leading drugmakers are preparing a push for legal changes to extend their period of protection from generic rivals. Industry executives say that **Bristol-Myers Squibb** CEO Peter Dolan, who now heads the **Pharmaceutical Research & Manufacturers of America,** an industry association, is likely to make the effort a top priority. A drug's patent protection typically lasts about 20 years. But it runs from the time a compound is discovered rather than when a drug gets **FDA** approval and comes to market, usually 8 to 12 years later. Generics makers aggressively attack patents on blockbusters, challenges that, if successful, further shorten the patent protection. There's also five years of "data protection," another right to exclusivity based on clinical trial results. This kicks in at approval. Pharma's complaint? Robert Armitage, **Eli Lilly's** general counsel, says the resulting exclusive periods under this system aren't long enough, given multiyear clinical trials. He wants 15 years of data protection, along with a 15-year patent, also granted at FDA approval. Such a scheme would effectively lock out generics since they would need to produce their own data in costly clinical trials. With the feds paying for Medicare prescriptions, any change likely to raise the bill will be a tough sell. Says Ira Loss, executive vice-president at Washington Analysis: "They are going to be hard pressed to move this very far."

–Amy Barrett

UNION DUES

THE UAW'S SOUTHERN DISCOMFORT

RON GETTELFINGER, the beleaguered United Auto Workers president, is in the fight of his career as he struggles to defend living standards at Detroit auto and parts makers. The last thing he needed to hear was that a brother union, the International Association of Machinists, has targeted the 3,000 workers at DaimlerChrysler's Mercedes-Benz factory in Vance, Ala. A furious Gettelfinger has complained to the AFL-CIO, which asked a labor arbitrator to sort out the matter.

GETTELFINGER

You'd think the UAW's hand would be the weaker one, since it failed to sign up the Mercedes workers in 1999. But insiders say the AFL-CIO feels pressure to stop the drive by the IAM, which represents just 12,000 auto workers, because it doesn't want Gettelfinger to quit the AFL-CIO. He considered bolting last summer, when a half-dozen unions left to form the rival Change to Win federation.

IAM President Tom Buffenbarger says the UAW's complaint is uncalled for. "The Mercedes workers came to us," he says. In the end, the dustup is largely about UAW pride. A union victory at Mercedes would be the first at a foreign-owned carmaker and would help to maintain high wages for all auto workers.

–Aaron Bernstein

SCREEN

NETFLIX, t online DV rental star has been buying the distributio rights for i films, inclu *Cowboy d Amor*, a documentary about a cowboy-tu matchmaker that opened in January. Ted Sarandos, chief content officer, says the g to help indies, which do well with Netflix' cinephile clientele, get reviews and buzz. (time, Sarandos hints, its new distribution r could also change Netflix' business mode least around the edges. (Its core rental m is at the heart of a patent infringement su Netflix just filed against Blockbuster.) HB notes, went from being a distributor to be creator. Can Netflix? We'll know in a few re

–Timothy J. Mu

BLOGSPOTTING

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» WHY READ IT For the observations on culture and business that make *Blink* author Malcolm Gladwell one of the hottest speakers on the conference circuit.

» NOTABLE POST "If, for example, a drug company came up with the best anti-depressant…we would EXPECT that drug to be associated with, say, more reports of suicide ideation. Why? Because it would be prescribed overwhelmingly to the hardest cases….We need to be very careful in how we interpret statistics purporting to show that…one kind of anything, is more dangerous than other things in its class."

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UPFront

JOB-SHARING

THE FAMILY THAT FLIPS TOGETHER...

To help reduce absenteeism and turnover—chronic problems for fast-food managers—McDonald's is testing an unusual program at some of its 1,250 British restaurants. Employees from the same immediate family can fill in for one another without clearing it with the boss, a new twist on job-sharing, according to Mercer Human Resources Consulting.

The so-called Family Contract is a response to surveys in which workers described juggling work and other duties as stressful. It permits family members—including same-sex partners—to sign on in pairs and take each other's shifts. Human resources chief Richard Floersch says if absenteeism or turnover drops by autumn, McDonald's may expand the program to include cousins and even friends. It may also import the Family Contract to some of the other 117 countries with its outlets. About 1.5% of its 60,000 British workers are related to one another, the company says, about the same rate as in the U.S., where McDonald's has more than 600,000 employees. *–Michael Arndt*

GRIPE ALERT

REVENGE OF THE IRATE SHOPPER

CAVEAT VENDOR: That disgruntled shopper snarling at the manager isn't the problem. It's the customer who complains about the store to friends. A new study shows that people told about a friend's or relative's bad shopping experience are up to five times as likely to avoid the store in question as the original unhappy customer.

One reason is that the tales of annoyance tend to be embellished with each telling. By the fifth rendition or so, "the sales clerk who was just unresponsive has become abusive," says Paula Courtney, president of **Verde Group,** a Toronto retail consultant that conducted the study with the Jay H. Baker Retailing Initiative at the **Wharton School.**

The survey of roughly 1,200 U.S. shoppers in the weeks before and after Christmas, 2005, delivers some particularly bad news to the big-box stores. It seems that customers of mass merchandisers like **Wal-Mart, Target,** and **Sears Holding's Kmart** share their negative experiences with an average of six people, double to triple the audience sought by customers who've had negative experiences at other retailers. The biggest gr about the big boxes: difficulty locating merchandise. Store managers at all types of outlets, meanwhile, are out of the loop because irritated customers are times more likely to ver friend than to a store re Says Stephen Hoch, wh heads Wharton's retaili initiative: "What retaile don't know can really c back to bite them." *–Robert*

PROXY POINTS

SHAREHOLDERS HAVE have so far filed more than 300 social issues proposals for the current round of annual meetings, down from the that were filed last year at this point. As the proxies roll in, these are emerging as the top concerns. *–Elizabeth V*

	ISSUE/TARGET SECTOR	FOCAL POINTS
	ENVIRONMENT *Oil, electricity, chemical, cosmetics, retail, food*	The most common proposal subject. While greenho gas reduction continues to be a major focus, this ye there's a new emphasis on asking companies to "m and reduce" hazardous chemical use in their produ and operations. **Proposals received so far: 50 to 60**
	EQUAL OPPORTUNITY *A wide range of industries*	Gay rights remains a prominent focus, with proposals for and against its inclusion in EEO policies. Gender bia issue for ExxonMobil shareholders objecting to spons of the Masters Golf tourney at Augusta National, whic women members. **Proposals received so far: about**
	POLITICAL CONTRIBUTIONS *Financial, telecommunications, pharmaceutical*	A hot issue since the 2004 elections. Church group socially responsible investing (SRI) funds, and the New York have joined labor unions in asking for reg reports on companies' contributions to political campaigns. **Proposals received so far: 30 to 40.**

Data: Jim Letsky, Senior Analyst, Institutional In

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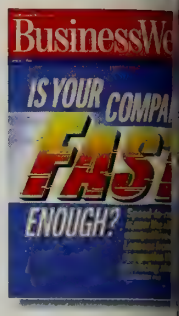
"Why hasn't the management of the automobile industry read the handwriting on the balance sheets?"

–Garrett U. Cohn
Baileys Harbor, Wis.



WHEN BEING A SPEED DEMON IS—AND IS NOT—THE ANSWER

IS ANYONE IN DETROIT reading *BusinessWeek*—especially your Mar. 27 issue ("Speed Demons," Cover Story)? The mentality of General Motors Corp. and Ford Motor Co., especially, is set in the 1950s and 1960s. Their answer to losing money is firing thousands and thousands of workers. Their response to losing market share is to ignore the signals to produce what consumers want and instead bribe them with discounts.

If speed-to-market is an answer to retaining and building market share, why hasn't the management of the automobile industry read the handwriting on the balance sheets? They have had enough time to remake their offerings.

–Garrett U. Cohn
Baileys Harbor, Wis.

I WOULD ADD another best practice idea to your playbook list: the art of listening. Most organizations have a direct connection with their customers through every employee who touches a customer. From the sales department to shipping and receiving, information on how to deliver new value through "speed" innovations abounds. Management's challenge i constantly ask employees how to n things faster and better. John Cham of Cisco Systems Inc. was known t this before passing out ice cream tc rank-and-file workers.

When corporations develop systen pause and listen, they will be abl speed things up in the areas of gre importance to their customers.

–Arnol
Rancho Palos Verdes, (

A SMARTER SOLUTION FOR PROTECTING AIRCRAFT

RE "HESITATION AT homeland secu (News: Analysis & Commentary, Mar While an officer in the Air Force, I he test various aircraft self-protection sys (including the Northrop Grumman (system on cargo aircraft mentioned in article) and ground-based missile i ceptors. Military aircraft need an onb protection system for shoulder-fired siles because they are likely to fly many different airfields for a variety of sions during their lifetimes. Comm aircraft always fly from one passenge port to another on a predictable sche A ground-based system at high-visi

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How the show always goes on. To a packed house.

Whether it is "Madama Butterfly" or Michael Bublé, every ticket at Sydney Opera House is a hot one. That's why they chose HP Integrity servers with Intel Itanium 2 processors. Now twelve times as many customers can access the ticketing system simultaneously, and downtime is a distant memory. Norman Gillespie, CEO says, "Maintaining our reputation is crucial. HP Integrity Itanium-based systems help ensure our customer experience is virtually flawless." itanium-integrity.com

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airfields (e.g. New York, Washington, Los Angeles, etc.) would protect all aircraft, could be made redundant, would have no weight, size, and power restrictions, and would have no deleterious impact on aircraft performance and maintenance. Moreover, there are far fewer runways than there are aircraft, so the overall cost of a robust system is likely to be lower. All aircraft are protected, including the very small and those coming from outside the U.S.

I do not doubt the ability of onboard systems to protect aircraft. However, I do doubt the business case for already struggling airlines—especially when one thinks about putting a $1 million system on a $20 million regional jet. Off-the-shelf systems have their places and uses, but we should not forget that off-the-shelf will not always mean cheaper and better.

–Alex Johnson
Former Captain, USAF
Ithaca, N.Y.

THINK PRUITT CAN SAVE PRINT NEWSPAPERS? THINK AGAIN

RE "NEWSPAPER GUY bets big" (Media Centric, Mar. 27): Gary B. Pruitt's $4.5 billion gamble on newspapers is preposterous. Pruitt may be the best in the newspaper business, but that won't compete with the speed of the development of online newspapers. More and more people are modifying their home pages through services such as Yahoo! Inc. and MSN to receive the information they want quickly, efficiently, and for free. If Pruitt can save the American newspaper, it will be the biggest thing since William Randolph Hearst.

–Thomas Callaway
San Diego

RISING WAGES FOR CHINESE WORKERS ISN'T THE ONLY STORY

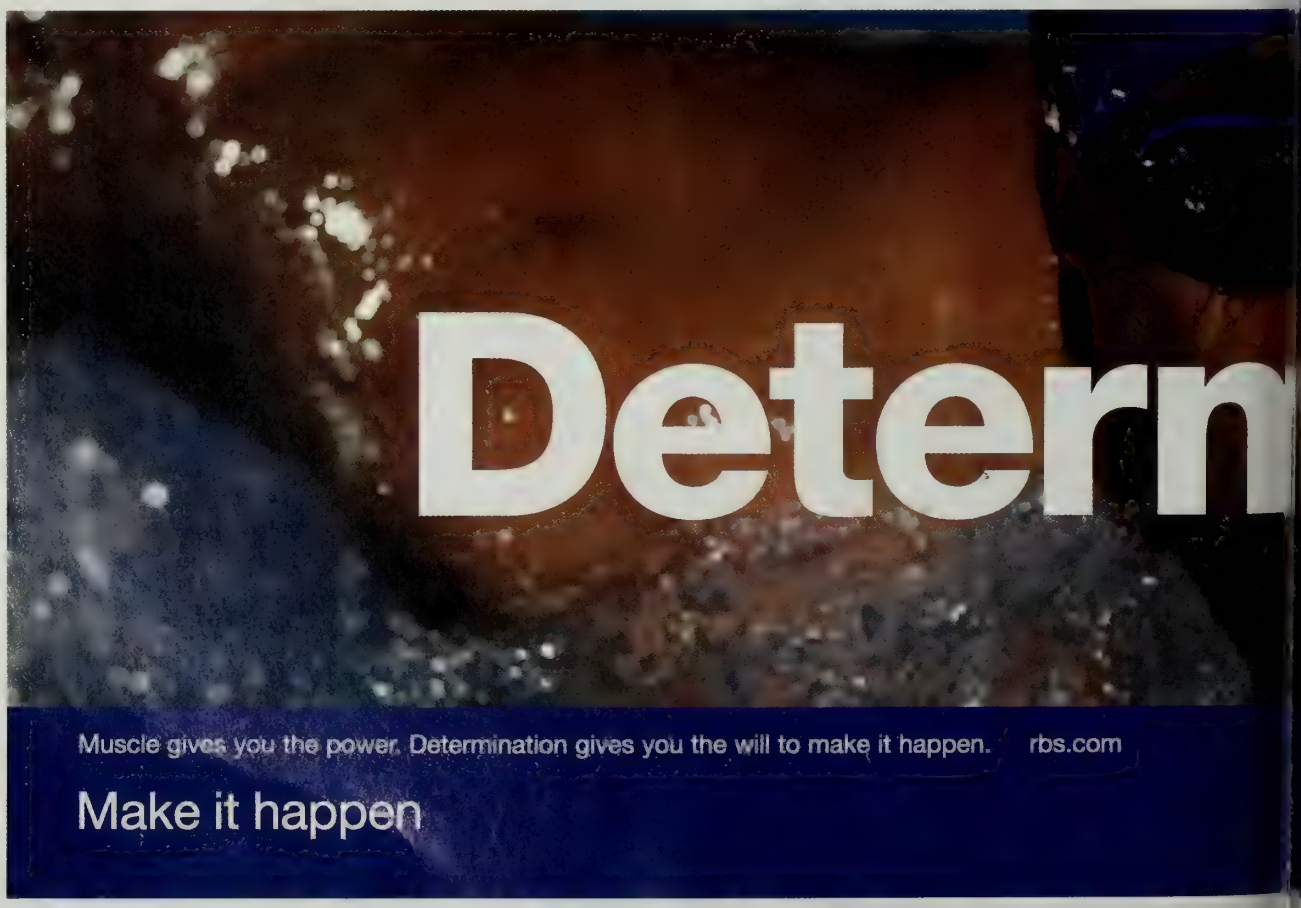
RE "HOW RISING WAGES are changing the game in China," News: Analysis & Commentary, Mar. 27): Rising wages of local Chinese workers and middle-level managers is far less problematic for multinational companies than operational waste and unfairness. My grandfather helped a Swedish pharmaceutical to build its first joint venture in my city. After 20 years that company is still enjoying its contractual privilege. Management lives lavishly, especially expatriate workers. This remains quite prevalent, and I believe multinationals have large room for cost reductions.

Meanwhile, huge salary gaps generally exist in multinational companies between local workers and expats. Even Chine H1B visa work status can earn much than fellow Chinese colleagues ir same job. Since most consumer pro are quite affordable in China, "global is actually a bonus rather than a w maintaining the home-country l standard. We will reach a new equi um in the labor market when large bers of overseas students (like us back, and when government refor education (like encouraging crea rather than memorization) take effe

–Shengxin
Salem

WHAT IS WRONG with this picture cause wages for Chinese factory wo have "surged" to $160 a month (4 hour for a 12-hour, 7-day week), shortages have "pinched" profit ma and are setting off inflation "alarm b in the U.S. Are we so blinded by our wealth that we begrudge a bare rise i standard of living for poor, exploited ple? Will global manufacturing's "hot spot" be East Africa, where wo can be paid in cups of corn?

–Bill T
Oakland,



RECTIONS & CLARIFICATIONS

s to cover every angle" (Personal ess, Mar. 27) misstated the expense of the DB Commodity Index Tracking The fund's expense ratio was ed to 1.30% as of Mar. 2.

ght of the UAW" (Workplace, Apr. 10) d have made clear that U.S. Steel didn't terminate the pension or health plans for its workforce prior acquisition of National Steel Corp. in However, the United Steelworkers did allow the company to buy nal Steel assets out of bankruptcy hat company had ended its retiree plan and dumped its pension plan he federal government. The union llowed U.S. Steel to terminate its n plan for all new hires and to freeze tributions to the retiree health plan workers.

Y, "IMPORTS from China aren't -yet." How about, "Imports from are pricier—already"? Anybody ports products from China knows ces have gone up substantially over the past year for products that contain metal and various other materials.

–Dan Rothman
Fountain Valley, Calif.

HOW TO SECURE THE MOVEMENT OF HAZARDOUS PRODUCTS

IN "THESE CHEMICALS are so deadly" (Science & Technology, Mar. 20), your "solutions" to securing the transportation of hazardous products throughout our nation come with unintended consequences. For example, although shipments may be rerouted when the federal government identifies heightened security threats, rerouting merely shifts those risks to other places. The Justice Dept., Homeland Security Dept., and Transportation Dept. all have agreed that local control of rerouting is not the answer. America needs a national solution to protect against terrorist attacks on the transportation of essential chemical products, rather than a patchwork of state and local quick fixes and knee-jerk reactions.

To ensure the timely delivery of essential products, America's chemical makers have been working with the railroads and federal security experts to improve shipping and inspection procedures, increase training and tighten screening for employees, enhance surveillance along rail lines, conduct security audits, improve emergency response capabilities, and create tamper-resistant shipping technologies, among other steps.

–Jack N. Gerard
President & CEO
American Chemistry Council
Arlington, Va.

How to reach *BusinessWeek*

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Just Plane Genius

WHEN BOEING CO.'S newest plane, the 787 Dreamliner, takes off for the first time in 2008, it will open a new chapter in passenger flight. The first commercial jet to be built out of lightweight carbon composites, it will burn 20% less fuel than other jets its size and give passengers a quieter, more comfortable ride.

The creative force behind the Dreamliner is Walt Gillette, the same man who provided the technical and intellectual inspiration for every Boeing jet since the mid-1970s. Gillette plans to retire when the Dreamliner enters service, but the planes he created, including the 737, the 767, and the 777, will be hauling people around the globe well into the 21st century.

One early battle Gillette fought and won involved the use of twin engines for long-range flights. Back in the 1980s, three- and four-engine aircraft dominated flights between Europe and the U.S. Gillette insisted that a twin-engine 767 widebody would be just as safe. In a few short years, such jets replaced most other planes. "I think Walt is one of the most significant contributors to the efficiency and safety of the global transportation system," says Alar Mulally, CEO of Boeing's commercial airplane unit.

Gillette, 64, is a courtly, soft-spoken Texan who has b Boeing since 1966. With two degrees in aerospace engineering, he embodies a culture of equal parts scienc pragmatism. It was in the late 1970s that he solved his f significant aerodynamics problem. The fledgling Southv Airlines Co. needed a small plane to break out of short h and fly across country. Gillette used an analytical metho called computational fluid dynamics (CFD) to crack the toughest design problems, including figuring out how t powerful new engines on the wings of a small 737. "Eve time we tried to put one of those big fat nacelles [engine enclosures] close to the wing, we got terrible aerodynan interference between the nacelle and the wing," Gillette recalled. "The extra drag made it unacceptable."

Gillette and his team traveled the world, looked at eve nacelle installation, studied them with CFD, and came u with a formula that changed aviation history. "We foun things, which remain trade secrets," he t in an interview, "five features that no on used in such a combination. It let us sh big nacelle really close to the wing." At time of the 737-300 launch in 1980, tota projected sales were 300 airplanes. Boe has since sold more than 5,000 of the narrowbody aircraft, making the 737 se the most popular commercial jetliner ev

Gillette: A lifetime designing safer, more efficient jets—and making Boeing money

For all of Gillette's dedication, Boeing get everything right. The 777, for exampl well be the pinnacle of aerodynamic perf But Boeing failed to rein in costs on the and profits initially were disappointing.

The Dreamliner, which seats up to 250, may turn o be Gillette's proudest legacy. In addition to providin comfortable cabin pressure thanks to the tough car frame, the plane's long range will deliver people di to where they want to go, avoiding congested hubs

Like all of Gillette's earlier jet designs, the Dreaml a hit. With 343 firm orders in less than two years, it's fastest-selling new airplane ever. That's important, bec in Walt's world, if jets can't make money, they aren't wort napkins they were sketched on. "The real challenge is to s what the market wants," he said. "The market decide the new technology is justified." But what really touches Gillette is the sheer impact of air tr On any given day, 600,000 people strear across the sky on Boeing jetliners, mak connections at the far ends of the eart wanted to work on something that wo benefit the world," Gillette said. It's s say he has succeeded.

–By Stanley

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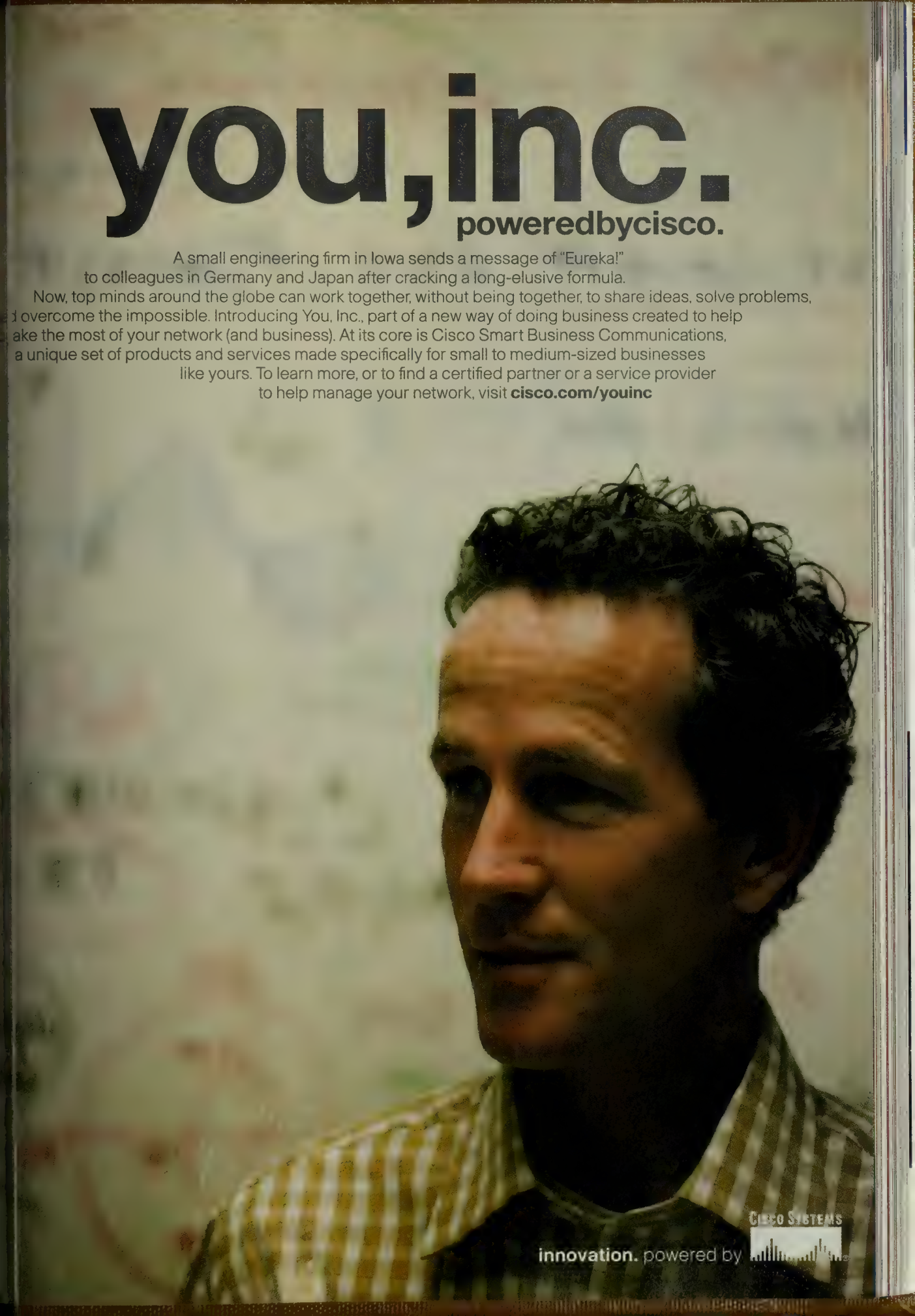

Technology&You

BY STEPHEN H. WILDSTROM

HDTV's Digital Disconnect

Cleaning up the rat's nest of cables linking my high-definition TV to various video devices seemed like a good idea. Instead of three analog video cables that connected my cable box to the display, I could have just one digital cord. Little did I know that going digital, which everyone will eventually have to do, would block my ability to see HD programming.

The problem stems from restrictive antipiracy measures imposed by companies that own the content. At best, the transition to HDTV was going to be confusing for consumers. But the piracy safeguards embedded in the hardware make it much more complicated.

Here's how it all played out in my living room. There's a cord called a Digital Video Interface cable that I tried to use to hook up the Motorola set-top box supplied by Comcast to my Sharp AQUOS TV. As soon as I plugged the cable in, a message on the screen announced that my cable had "failed HDCP authentication" and that the box was reducing the picture resolution to 480i. That's digital TV-speak for standard TV. Like a prince turning into a frog, the picture degraded and shrank into an unsightly rectangle in the center of my big screen.

I had some idea of what had happened. Content owners insist that any transmission of digital programming between devices in the home must be over a secure link, so that you can't intercept the content and make a copy. Specifically, they require the use of an Intel-developed encryption method called High-bandwidth Digital Content Protection, or HDCP.

THE CONNECTION I USED met the content protection requirements of both the set-top box and the TV. Unfortunately, the Motorola box and the Sharp TV were unable to talk to each other to establish a secure connection. So the set-top box sensed that it was hooked up to an unprotected digital connection and downgraded its output to standard definition. Having been through this kind of thing before, I knew how to reconfigure the set-top box to go back properly to the analog connection, saving me the pain of a Comcast tech-support call.

This situation is unconscionably complex even for the most tech-savvy consumer. There are two types of digital cable that can be used for secure connections, the DVI cable that I used and a new type of cord called High Definition Multimedia Interface. HDMI connectors are nearly 100% certain to comply with the copy protection standard, but they are still fairly rare; my display has one, but noth else I own does. DVI connectors ar much more common but less likel be compliant. And some HD displ especially older ones, lack any con ant digital input. That's why most ple hook up their digital systems v analog cables.

But that solution may not work definitely. Hollywood wants to for the use of digital cables so that stu can enforce copy-protection schem And they may use the advent of hi definition DVDs to press their case er this year two high-def DV formats will arrive: Blu-ray a HD-DVD. Content owners ca clude codes that will downg the image you see to someth well short of true high-def if try to use analog cables.

Piracy safeguards make the switch to digital TV far too complex

There's one glimmer of ho for consumers. Silicon Image company that helped develo HDMI standard, has set up a sidiary called Simplay to test patibility. Its system should b place by the time high-def D are available. Then you'll know that a DVD player will wor with an HDTV set as long as both bear the Simplay logo.

Simplay should be a big step forward. But for HDTV to ceed in the mass market, content owners, service provider and equipment makers need to impose a sanity check on tent protection. If preventing piracy trumps all other cons tions and makes it too hard for people to use these expens new systems, the market will never reach its potential. ■

E-mail: techandyou@businesswe

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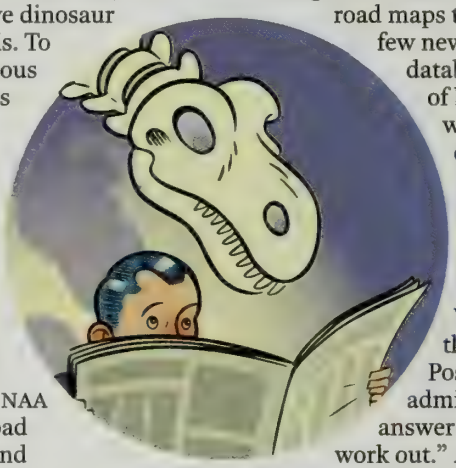
MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Life Among the Dinosaurs

There are almost 1,500 daily papers in the U.S., so the gathering of publishers at this year's Newspaper Association of America annual conference—held Apr. 2-4 in Chicago—looked a lot like America. An America of local monopolists, that is: overwhelmingly white, male, late-middle-aged, and predisposed to wear suits on Sunday, even when traveling. They gathered to hear, once again, that the whole problem is that they are no longer monopolists.

At every NAA convention, these men attend nightly parties in the host city's grandest public spaces. This year's opening event was at the magnificent Field Museum, on a large open floor bookended by two massive dinosaur skeletons. Many attendees joked about this. To the executive to whom I said such an obvious metaphor would never, ever, appear in this column: I lied.



IT IS MORNING. New York Times Co. Chairman Arthur Ochs Sulzberger Jr. scans a copy of his paper. P. Anthony Ridder, chairman of Knight Ridder Inc., whose company was just sold against his will, stands in the foyer, surrounded by men wearing grave and sympathetic expressions. At the podium, Jay R. Smith, Cox Newspapers' president and outgoing NAA chairman, gives a valedictory with the broad theme of "stop whining." It begins with and repeatedly uses the phrase, "It wasn't supposed to turn out like this." He also says: "The world changed a lot. Newspapers changed a little." But, come on, that's old news. Newspaper guys know they need to rip up the playbook. They've been talking about it for at least 10 years.

THIS IS THE PART OF THE COLUMN where we point out that newspapers are far from dead. That it's still fabulous owning a successful small paper in, say, Appleton, Wis., even if it's no longer fabulous owning a besieged big city daily in Philadelphia or Boston. This is where we point out that newspapers still throw off buckets of cash and churn out 20%-plus profit margins. Where we point out how hard it would be to dislodge most newspapers from their market positions. And that certain papers are making very smart moves online, be they *The New York Times,* which is using more video and blogs, or *The Greensboro News & Record,* which is embracing reader-written articles.

This is also where we recall that newspapers historic have been slow to change and to tap existing assets in n ways. Any newspaper sits on enormous market intellige through its classified-ad databases, which represent ric road maps to a town's desires and buying habits few newspapers mine them for ad-targeting database deals. Newspapers remain the k of business in which executives say the waiting to see the reaction to the *Tim* decision to drop its stock tables, whi they all should have done God know how long ago.

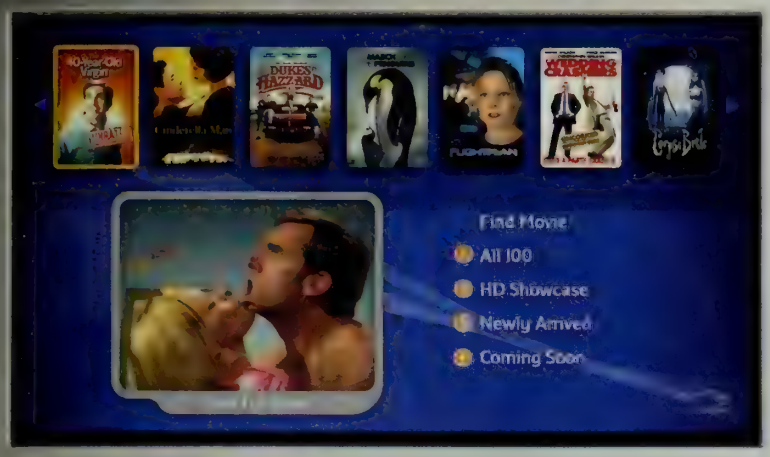
ALL OF THIS PARTLY EXPLAINS why D E. Graham, chairman and CEO of Washington Post Co., goes from boa that 82% of the nation's capital uses Post product daily to conceding, with admirable candor, that "the only honest answer is we don't know how our future wi work out." All in the span of three minutes.

THIS YEAR THE NAA HIRED the Martin Agency to promote newspapers' power as ad vehicles. Onstage, Martin's cl strategy officer, Earl Cox, says running ads in places lik AdAge.com and adweek.com is "the best way to interce key marketing executives: "They're online a lot." He th tries to act like it's good news that the second-best plac run a campaign trumpeting local newspapers' ad stren in a local newspaper.

AT THE CONFERENCE, an Associated Press presentation a speech by Senator Barack Obama (D-Ill.) hammered a problems posed by America's outsize oil consumption the AP event, I encountered a delightful newspaper executive—ruddy-faced and white-haired—in the elev No conservation measures for this guy! "I'm just gonr up my SUV and go out in a blaze of glory," he all but h as the doors shut.

In many ways, that is precisely the problem with newspapers. ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia



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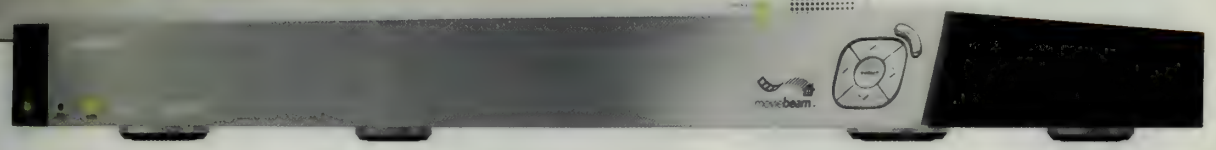

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AMES C. COOPER

's Way Too Early o Count Consumers Out

ng household wealth and healthy job markets will support spending

U.S. ECONOMY The most important question mark in the economy t now is the American consumer. Last year spending by seholds accounted for 71% of the growth in the economy, and it ributed to another solid showing in the first quarter. Typically, as sumers go, so goes the economy. So will they continue to be the ngine powering economic growth or will they start to sputter?

worries seem real enough: Housing activity and re cooling down, suggesting less spending on fas, rugs, and dishwashers, as well as less cash for ers to milk out of their home values. Plus, interest e continuing to rise, lifting borrowing costs at a hen personal savings are nonexistent. Now e prices are spiking again, threatening to rob power this spring. That's enough to raise a red ut consumers' staying power, right?

, maybe only a yellow flag. One rule that has paid dividends for economy-watchers in recent nd even during the 2001 recession is: Never sell ers short. Clearly, the list of challenges facing olds in 2006 is growing, and spending this year hard-pressed to match last year's 3.5% advance. he same time, the resources needed to meet those ges are also growing.

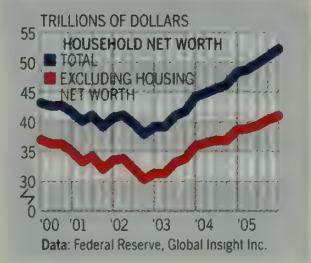
aps most important, a key difference between now t business cycles is the increasing role of old wealth, measured as the value of assets minus es. In the past three years, the relationship n income and spending—historically, one of the in economics—has weakened considerably, because the net worth of households scored the three-year growth on record. To a great extent, gains have supplanted income growth as a key under spending.

year, wealth gains will continue to provide a oundation. Even as slower growth in home prices the additions to real estate wealth, gains in l assets will take up much of the slack. At the me, improving job markets and faster wage will be lifting household incomes.

OSE OBSERVERS wedded to traditional analysis mer behavior, the disparate trends in income and g have set off alarm bells. Consider that, in each ast three years, real consumer outlays have grown an real aftertax income. With households ding their paychecks, the official measure of the l savings rate has turned negative. That's because the government measures savings as what's left over from aftertax income after subtracting all outlays.

But as the pattern of the past three years shows, a zero savings rate, as traditionally measured, means nothing about the financial condition of households, at a time when consumers are saving from sources other than income, and when they are spending part of their increased wealth. In February, the savings rate was -0.5%, following a -0.4% average for 2005. But last year, household net worth rose by $3.9 trillion. Economic studies generally agree that households tend to spend about 4¢ of every dollar of additional wealth. To put that in perspective, 4% of last year's rise in net worth is equal to nearly 30% of last year's increase in consumer spending.

WEALTH GAINS ARE BUOYING CONSUMERS



Data: Federal Reserve, Global Insight Inc.

That's why signs of stress are hard to find. Delinquency rates on a broad range of loans remain low, and despite gasoline prices jumping to a national average of $2.59 per gallon in early April, consumer confidence last month rose to the highest mark in almost four years. And first-quarter consumer spending appears to have grown at an annual rate of around 5%, which would turn out to be the strongest quarterly showing in 2 ½ years.

THE RECORD INCREASE in household net worth over the past three years, totaling $13 trillion, will continue to boost consumer spending in 2006, and new wealth gains this year will provide additional lift. That's true for two reasons. One, studies show that wealth affects spending with a lag, so increases last year will continue to support outlays this year. And two, the rise in wealth generated by the increased value of financial assets has swamped the increase in equity coming from household real estate. That means, unless the stock market really tanks this year, wealth will most likely continue to rise.

In fact, worries about how the weakening in housing

could depress consumer spending this year may well be exaggerated. The popular concern is that weaker housing activity and home prices will prevent consumers from using their homes as ATMs. By some measures, the net equity that homeowners have withdrawn from their home values was equivalent to more than 6% of households' aftertax income in both 2004 and 2005.

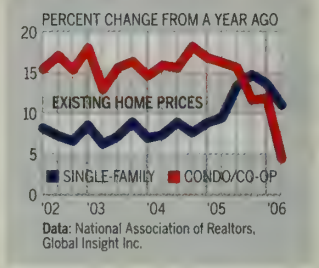
However, separate studies by economists at both Barclays Capital and JPMorgan show that the relationship between home-equity withdrawals and consumer spending is highly suspect. Their analyses show that the more important relationship is between wealth and spending. The wealth data suggest that much of the equity taken out of homes has found its way into other financial assets, and much of that remains stored away as retirement savings or in more liquid assets that can quickly be spent.

CLEARLY, OUTLAYS for an array of home-related goods are bound to fall off. But for net worth to suffer a loss big enough to threaten overall spending, home prices would have to collapse broadly, and that seems unlikely.

Housing turns on mortgage rates, the variation in which has accounted for more than 75% of the monthly ups and downs in sales of existing homes over the past 10 years. Based on past patterns, if the yield on 10-year Treasury notes rises to 5.5%, from 4.8% now, 30-year fixed mortgage rates would be in the 7%-7.5% range, up from about 6.5% now. That would add about $65 per month to a mortgage payment for each $100,000 of principle. That's not likely to cause much damage.

Consider that even if home values do not rise at all year, and mortgage liabilities continue to grow about per year, then homeowners' equity would fall by abou $1.2 trillion. However, if financial assets continue to r at the 9.6% annual pace of the past three years, or $3 trillion, then the over net worth of househo would still increase b some $2.3 trillion. Pl most homeowners w still have significant untapped capital gai racked up from price appreciation over the past several years.

WHERE HOME PRICES ARE SLOWING SHARPLY



Data: National Association of Realtors, Global Insight Inc.

Home prices are already starting to gr more slowly, but so fa the cooling has been sharpest for new homes and existing condominiums cooperatives. In the key market for existing homes, w is more crucial to household wealth, prices are still u 11% from a year ago, after peaking at 14.7% in the thi quarter of last year (chart).

Prices are bound to slow more in the coming year, U.S. housing markets come back to reality. But as lon the adjustment is gradual, there will be plenty of new gains in household wealth and income to keep consu spending at a healthy, if slightly slower, pace. ■

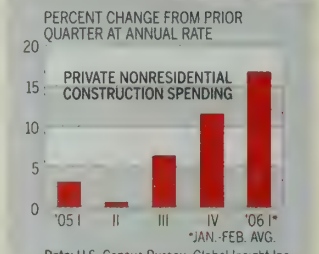
BUSINESS CONSTRUCTION

Picking Up the Slack from Housing

STRONG DEMAND has caused many companies to outgrow their facilities, and the unflappable consumer has driven retailers to build more stores. As a result, business construction spending should remain strong as vacancy rates fall and factory utilization rates rise. It's a trend that will help cushion the blow from the coming decline in housing.

In February, private nonresidential construction outlays, which cover hotels to factories, rose 9.6% from a year ago. That was the fastest yearly rise in over five years. The gains have been broad, but outlays for commercial space, offices, and factories account for the majority. The three sectors make up just over half of private nonresidential construction, but accounted for nearly three-quarters of the increase in outlays over the past 12 months.

BUSINESSES NEED MORE SPACE



Data: U.S. Census Bureau, Global Insight Inc.

Signs point to continued strength. Metropolitan office vacancy rates are falling. According to CB Richard Ellis Group, a commercial real estate services company, the national rate fell to 13.9% in the final quarter of 2005, the lowest in four years.

The level of available space is even more scarce for manufacturers, down to 9.7% in the fourth quarter of last year. With business investment expected to remain strong in 2006 and with capacity utilization above its long-term average and expected to keep rising, manufacturers will need to expar existing plants or build new facto

Indeed, the push to build more offices and stores will help to fuel business investment. In the first t months of the first quarter, produ of construction equipment is up l annualized rate of 18.2% from th previous quarter. What's more, th February level of unfilled orders v up 28.5% from a year earlier, indicating further rises in produc

Increases in nonresidential building activity should also miti some of the fallout from reduced homebuilding. Hiring in residen building is slowing. Meanwhile, three years of trimming workers. payrolls in nonresidential buildi have steadily risen since mid-20 up 3.2% in February from a year earlier. As companies need to sp more on building, hiring in busi construction should keep impro

–By James Mehring in New

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News you need to know

EDITED BY HARRY MAURER

Telecom Titans Tie the Knot The markets are blessing the $13.4 billion nuptials of **Alcatel** and **Lucent,** creating the global No. 1 telecom-equipment maker. Although Alcatel is doing the buying, the French don't seem to mind that an American, Lucent **CEO Patricia Russo** (above), is set to run the $25 billion-a-year company, while Alcatel **CEO Serge Tchuruk** (above) becomes non-executive chairman. Even left-wing daily *Libération* praised Russo as a smart, down-to-earth boss with a deep *amour* for chocolate.

Expect a short honeymoon, though. Employees on both continents express alarm over a planned 10% cut in the combined 88,000-person payroll. The company also needs approval from France and the U.S. to spin off sensitive defense-related units. Smaller rivals such as **Ericsson, Nortel,** and **Siemens** may start seeking mates as well.

ONLINE *See "The Alcatel effect," www.businessweek.com/go/tbw*

Apple Does Windows Tremors shook techdom on Apr. 5 when Apple announced software dubbed **Boot Camp** that lets Mac users run Windows. For many PC buyers—from corporate graphics departments to consumers disgusted with Microsoft's virus-prone operating system to people tired of their PCs but still attached to a few Windows programs—the move cuts much of the risk of jumping to the Mac fold. Apple shares hopped 9% on the news as analysts talked of the company increasing its 3% slice of the market by several percentage points. One caveat, however: Apple says it won't do tech support for Boot Camp, and **Microsoft** may not support Windows on Macs, either.

A New Driver for GMAC **GM** continued to overhau power train. On Apr. 3 it agreed to sell 51% of its fina arm, GMAC, to a consortium led by **Cerberus Capital Man ment.** The deal will pump $14 billion into GM over t years. It also may boost GMAC's credit rating and lowe cost of capital. But half the unit's rich profits will now to Cerberus and its partners, including **Citigroup.** GM n cash to buy out workers and develop models with pizz Its March sales plunged 14.6% from the year before.

See "Getting out of Dodge," page 80,

ONLINE *"GMAC: Is GM selling its seed co. www.businessweek.com/go,*

Delphi: *'En Garde!'* This won't make life any easie **GM.** On Mar. 31, as expected, bankrupt auto parts m Delphi asked a federal court to junk its labor contracts can lay off 20,000 hourly workers and slash wages fo rest. The judge won't rule until June, and talks with the may yield a compromise. The union hasn't authoriz strike yet. It's not clear it would walk anyway, since a stoppage would likely topple GM into bankruptcy, too.

ONLINE *See "Twilight of the U www.businessweek.com/go*

The Healthiest State Who says universal health ca a pipe dream? Massachusetts seems to have found a way to achieve it—without a state takeover. On Apr. legislature passed a bill that would require all residen buy health insurance by July 1, 2007. Low-income citi would get big subsidies. More affluent folks would stiff tax penalties if they didn't buy coverage. Repub **Governor Mitt Romney** is expected to make the bill a ce piece of his likely run for the White House.

ONLINE *See "In Massachusetts, Health Care for www.businessweek.com/g*

Chávez Flexes Some Muscle **Venezuelan Pres Hugo Chávez** may be sitting on the world's largest oi posits—as many as 250 billion barrels. Although ju billion are proven reserves, that still makes Venezu force to reckon with. Chávez sent a message to Big C Apr. 3 when **Energy Minister Rafael Ramírez** told **Tot** France and **ENI** of Italy to return two fields because the fused to take on state-run **PDVSA** as majority shareh Sixteen other companies bowed to the new rules.

ONLINE *See "Venezuela's seizure ups the a www.businessweek.com/g*

Will Someone Grab CSC? While computer ser companies aren't exactly sexy, suffering stodgy growt cutthroat competition of late, their long-term cont and steady cash flow make them juicy takeover bait. candidate: **Computer Sciences,** which put itself on the on Apr. 4. Joseph Vafi, tech analyst at Jeffries & Co. potential buyers such as **IBM, Hewlett Packard,** and pri equity firms may have to pony up more than $11 billi

ONLINE *See "Computer Sciences goes on the b www.businessweek.com/g*

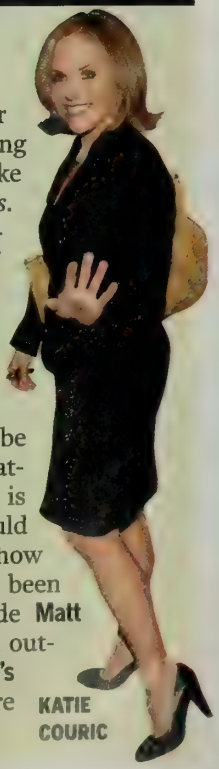
ay Calls It Quits They won't have **Tom DeLay** to around any more. The former superpartisan **House ity Leader,** who was forced out of the top spot in ember, said on Apr. 3 that he won't stand for re-ion from Texas' 22nd District. It looked as if he t lose, largely because of legal woes. DeLay faces aign-finance charges in Texas, and his ex-deputy of staff, **Tony Rudy,** recently pled guilty in federal to conspiracy charges in the widening probe of lob- **Jack Abramoff.** DeLay's exit may well help his party on to his seat.

trafund's Velvet Rope **Fidelity** and its **Magellan Fund** mers learned the hard way that swelling assets can performance. The Boston giant isn't about to make me mistake with its current crown jewel, the top-per-ng and top-selling Contrafund, managed by **Will** f. The growth fund, which climbed 16% last year and ged 11% over the past 5 years, will snub new investors Apr. 28. At $65 billion, Contrafund was getting un-y even for Danoff, a quirky manager whose far-rang-esearch has created a more eclectic portfolio than big funds employ.

doff in Atlanta In another game of company- brinksmanship, **Delta** pilots on Apr. 4 voted over-ningly to O.K. a strike if an arbitration panel tosses contract. Delta, in Chapter 11, is seeking more than million in concessions on top of the $1 billion the pi-cked in before the bankruptcy. The union has offered million. A strike would likely ground Delta for good, iders expect the two sides to shake hands on a deal.

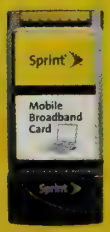
New Job of the Week

is the worst-kept secret in TV land: *y Show* co-host **Katie Couric** told her ence on Apr. 5 that she was "listening er heart" and ditching **NBC** to take as anchor of the **CBS** *Evening News.* CBS **CEO Leslie Moonves,** the 49-year-Couric represents a chance to spiff e Tiffany Network's dowdy image her trademark enthusiasm. In-s say NBC offered her $20 mil-to re-up, while CBS will pay her million but spare her the 4 a.m. -up calls. Couric's defection could be w to *Today,* which mints an estimat-250 million a year in profit. But is really sorry to see her go? This could e perfect time to liven up the show a fresh face, and the network has been g out substitutes to sit alongside **Matt** . The top choice appears to be an out-: **Meredith Vieira,** co-host of **ABC's** *View.* She'd come cheap, a mere million, but she hasn't signed yet.



KATIE COURIC

The Yes-man who turns high-speed wireless access into high-speed winners.



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TWO AMERICAS

COMPANIES IN THE CROSSFIRE

The politically passionate are taking aim at businesses they see as repugnant. Red or blue, they can be a PR nightmare

BY RICHARD S. DUNHAM

WHEN MARTHA E. Ture took a road trip from Indiana to California on I-80, she ate at Subway restaurants rather than Wendy's or McDonald's. When she last flew to Las Vegas, she took United Airlines, not American or Continental. When she drinks beer, Ture, who describes herself as a "writer, singer, guitar picker, nature lover, [and] politico," eschews Coors for Sierra Nevada. She stays at Hyatt hotels (never Marriott), and, when she visits a big-box discount store, she always patronizes Costco, not Wal-Mart.

Then there's Jennifer Giroux of Madeira, Ohio. The mother of nine, a registered nurse and Christian-bookstore owner, always gets her pizza at Domino's. She never takes the kids to Ben & Jerry's, opting instead for Cincinnati hometown favorite Graeter's Ice Cream. At the mall, she won't allow the family to walk anywhere near Abercrombie & Fitch, famous for its suggestive advertising. And when she does laundry, and she does a lot, she never buys Procter & Gamble's Tide detergent or Bounce fabric softener.

Ture and Giroux don't have much in common. But they do share a trait: Their product choices are driven not by low price or customer service, but by politics.

Like millions of Americans, these two consumers choose—or avoid—certain companies because of the political donations of their management or the controversial causes they support. Squeezing companies for political reasons is nothing new, from the Red Scare boycotts of 1950s TV advertisers to the anti-apartheid divestment drives of the '80s. But the movement has exploded in recent years, driven largely by the popularity of talk radio and the revolution in modern communications technology. Across cyberspace, dozens of Web sites, blogs, and listservs tell true believers which brands to buy or boycott.

DEFUSING REVOLTS

THE RISE OF THE ideological consumer has forced companies to reassess their marketing strategies and created a business boomlet for public-relations specialists whose expertise includes defusing po-

JACK BLACK

IN THIS SECTION:

Nailing tax dodgers with software

36 Avian flu: A new fear surfaces

40 eBay's bid for the impatient buyer

42 Why malls are kicking out teens

Big-box bull's-eyes: Wal-Mart draws fire from the Left, Target from the Right and Left

litically based customer revolts. A boycott "distracts [companies] from their corporate strategy, it causes them unwanted publicity, and it takes them off-message," says Bob Witeck, CEO of a Washington (D.C.) strategic communications and marketing firm who has counseled Ford, American, and other companies.

Targeted businesses "have to tread this incredibly fine line," says corporate communications strategist Arthur C. "Bud" Liebler, former senior vice-president for communications and marketing at Chrysler Corp. "There used to be a tendency by companies to ignore all [the attacks] and hope they'll go away. Now you can't ignore them because of all the Web sites, talk radio, and alternative newspapers." In addition, Liebler warns, "when you get into these political or religious things, you're never going to please 100% of your customers. Your goal is to do the least damage."

> "You're never going to please 100% of your customers," says a communications strategist. "Your goal is to do the least damage"

BAD TO WORSE

CRISIS COMMUNICATIONS strategists say some companies get it right. They cite P&G and Miller Brewing Co. for responding to incipient crises by reaching out to angry consumers and communicating a concise, consistent, nonpolitical response. But others only compound their woes. Ford and Microsoft Corp. changed positions in their attempts to appease critics, only to face an even stronger backlash from the other side.

What makes businesses so uncomfortable is the passion that activists, on both the Left and the Right, bring to their causes. Giroux says she'll spend more to patronize a socially conservative company and will abandon favorite brands if she dislikes the manufacturer's marketing or political choices. She gave up Tide because she received an e-mail from the American Family Assn. (AFA) in Tupelo, Miss., saying P&G had run ads showing men together in bed. "If they're not pro-family, we don't feel they deserve our dollars," says Giroux. "It's a sacrifice we're making to let them know that we don't agree morally with what they're doing."

Ture, like many liberal economic warriors, was jolted into action by President George W. Bush's 2004 reelection. "If everybody who voted Democratic in 2004 shifted just $100 from red to blue corporations, that would represent a shift of $5 billion in the economy," says Ture, 60. Wal-Mart, a big GOP contributor, is a major target of the Left because it provides its workers only limited health-care benefits. Wal-Mart declined comment.

Conservatives play the political game, too. They've targeted a range of companies—including Ford, Microsoft, Target, Walt Disney, H.J. Heinz, Ben & Jerry's, and P&G—for everything from backing gay-rights groups to banning the Salvation Army in front of their stores at Christmastime.

A network of 35 religious groups called Positive Christian Agenda is urging shareholders to dump the stocks of Microsoft, Nike, and Boeing, all of which backed a Washington State law to ban discrimination based on sexual orientation in housing, employment, and insurance. The group says it could cost Microsoft founder William H. Gates III around $200 million for each dollar the stock drops. Microsoft declined comm

Boycott efforts sometimes veer slapstick. In 2004, Teresa Heinz widow of Senator H. John Heinz III, headlines campaigning for her se husband, Democratic Presidential c date John F. Kerry. Conservative talk-hosts told red voters to buy ne Ketchup instead of H.J. Heinz' sign product. The upstart's slogan: "You support Democrats. Why should ketchup?" Heinz limited the dama quickly issuing a statement noting Mrs. Kerry had nothing to do wit company. One corporate counselor Heinz let the world know that "Ter not on the assembly line stomping t toes, and the money is not going to h

Three conservatives angry at Be Cohen and Jerry Greenfield, the l founders of Ben & Jerry's Home Inc., launched Star Spangled Ice Cre 2005. Its flavors include Iraqi Rc Hate the French Vanilla, and Sr GovernMINT. "We're trying to app conservatives, red states, and NA dads who like Ben & Jerry's ice crea can't [swallow] their politics," says President Richard Lessner. The bou brand is available online, at retail o in the Mid-Atlantic region, and at 1 itary bases in Texas. Lessner says its continue to build as conservatives up and spoon it down.

Some companies are caught in th litical crossfire. Social conservativ

(L-R) PHOTOGRAPHS BY (McDONALDS) NONE; (ARBY'S) TIM BOYLE/GETTY IMAGES; (COORS) DESMOND POCHS/SIPA PRESS; (GALLO) SCOTT OLESON/GETTY IMAGES

ting Ford because, they say, the aker reneged on a promise to stop g groups that advocate gay mar- But Ford is also under attack from groups for funneling 84% of its al action committee donations to licans in the last election. Target boycotted by the Right for barring on Army bell-ringers outside its last Christmas, is being bashed by t for sending 76% of its PAC mon- he GOP in the 2004 election. And fighting off a ketchup rebellion, is criticized by liberals for sending f its PAC's campaign cash to Re- ans over the past decade. With an- stomers on both sides, many com- decide it's best to lie low. ever we say, we just don't win, so n't say anything," says one embat- ecutive.

that's the wrong approach, com- ations consultants say. Instead, a ny should try to defuse a situation it gets out of hand. Miller Brewing case study. In 2004, Miller's PAC d $2,000 to House Judiciary Com- Chairman Jim Sensenbrenner (R- uthor of the tough immi- bill that passed the in December. That ted an immigrant- group, the Chicago ittee Against H.R. 4437, unce a boycott of Miller's n Mar. 10, the day of a massive pro- immigration rally in Chicago. One of Miller's Chicago marketing managers, Matt Romero, got wind of the boycott when distributors said orders dropped off from bars and retailers.

The company immediately sought a meeting to discuss the situation. On Mar. 15, Romero joined a five-person team led by Nehl Horton, Miller's senior vice-president for communications and government relations, to meet with group leaders at a community center in Pilsen, a predominantly Latino Chicago neighborhood. Miller agreed to run newspaper ads opposing the legislation and helped to facilitate meetings between immigrant rights backers and lawmakers. On Mar. 18 the group officially ended its boycott.

WHIPSAWED

THE LATINO GROUPS chalked it up as a win. "We think it was an important victory," says Carlos Arango of Casa Aztlán, one of the 100 organizations in the protest committee. But the outcome was also a triumph for Miller, which resolved the situation before it wreaked havoc on business. Instead of responding defensively, Miller used the situation to reinforce its image as a corporation that's committed to diversity.

In contrast to Miller's sure-handed action, Ford's response to political threats complicated a sensitive situation. The AFA and 20 other groups first threatened a boycott of Ford in May, 2005. Top company executives met in Dallas with religious leaders and Ford dealers. On Nov. 28, Ford agreed to end its sponsorships of Gay Pride parades and stop sales promotions that give donations to homosexual rights organizations based on the purchase of vehicles.

But the auto maker reversed itself after an angry response from gay rights groups, and the conservative boycott began on Mar. 13. "Ford had to make a choice: support the homosexual groups or the mainstream values of its customers and dealers," says Randy Sharp, the AFA's director of special projects. Twice burned, Ford now chooses to remain silent. Says spokeswoman Kathleen Vokes: "All we can do is remain focused on building high-quality vehicles."

Many companies sympathize with Ford and believe it is unfair for activists to seek economic revenge. Take Wendy's, for example. Although the hamburger chain's PAC has given 93% of its campaign contributions to Republicans over the past five years, it views itself as a "nonpolitical company" that does not take positions on controversial issues, says spokesman Denny Lynch: "We serve customers on both sides of the aisle." Wendy's backs winners, he says, and today those incumbents are mostly Republican. "We're not a red company," Lynch says. "If Democrats start winning, we'll move our money to Democrats. It's just business."

Other companies say it's better business to steer clear of politics. Costco has won praise from liberals as the un-Wal-Mart, with higher wages and better benefits. But Costco CEO James D. Sinegal has not created a corporate PAC because "we don't believe a public company should take shareholders' money and support political candidates or causes." He and Chairman Jeffrey H. Brotman donate heavily to Democrats, Sinegal says, "but we do it with our own money. I'm a merchant, not a politician." Most American merchants would agree—if only the activists would leave them to their business. ■

–With Adrienne Carter in Chicago, Stanley Holmes in Seattle, and bureau reports

R

IN THE AIR
Continental has the reputation of being a tough-on-labor employer, and it gives two-thirds of its political contributions to the GOP. United is the only major airline PAC to favor Democrats every year since 2000.

D

R

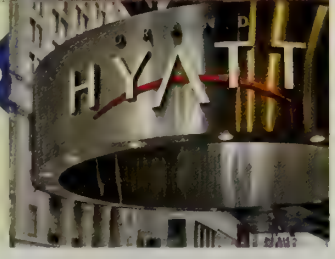
AT THE PUMP
ExxonMobil has consistently favored the GOP. Hess executives have backed Democrats, including Kerry.

D

R

CHECKING IN
Marriott is conservative and proud of it. Hyatt's Pritzkers have long bankrolled Dems, including Senator Barack Obama.

D



(CLOCKWISE FROM TOP RIGHT) PHOTOGRAPHS BY DONALD R. WINSLOW/ BLOOMBERG NEWS (UNITED); KEVIN P. COUGHLIN/BLOOMBERG NEWS (HESS); JEREMY M. LANGE/ REFLEXNEWS (HYATT); DOUGLAS C. PIZAC/AP/WIDE WORLD (MARRIOTT); DONNA MCWILLIAM/AP/WIDE WORLD (EXXON); DOUG MILLS/AP/WIDE WORLD (CONTINENTAL)

AUDIT TRAIL

IF YOU'RE CHEATING ON YOUR TAXES...

States and the IRS are mining personal and business data to sniff out scofflaws

BY HOWARD GLECKMAN

THE TEXAS COMPtroller's Office suspected for years that well-heeled Lone Star citizens were buying big-ticket private planes out of state to dodge sales taxes. But the tax collector couldn't prove it. Then the agency installed new computer technology that matched federal airplane registrations with state tax records. In just the past six months, Texas has collected $5 million in unpaid taxes from 43 scofflaws.

As tax season nears its Apr. 15 peak, revenue agencies are reaching for a software tool kit that has long been popular in Silicon Valley and in the back offices of big retailers. A combination of advanced data mining programs and vast repositories called data warehouses is allowing the taxman in about a dozen states to gather and analyze unprecedented heaps of information about individuals and businesses, especially small companies.

BEYOND THE TAX RETURN

THESE STATES, AND to a lesser extent the Internal Revenue Service, increasingly rely on such software to help capture a chunk of the more than $350 billion in annual taxes that are owed but never paid. California alone has used such systems to identify 600,000 non-filers and collect an extra $184 million annually. "Business has been using this for years," says Massachusetts Revenue Commissioner Alan LeBovidge. "It allows us to sort data that is beyond human ability to sort manually."

Until recently, the only data revenue agencies gathered on most taxpayers came from the returns they filed. And while other information was theoretically available, few agencies ever found it because they were saddled with creaky computer systems and a shortage of staffers with the necessary technical skills. "We would try running programs on a mainframe," says Lisa McCormack, area manager for the Texas Comptroller's Audit Div., "but it took forever."

For now, most state data mining programs simply gather information from other government agencies, such as U.S. Customs and Border Protection and state motor vehicle and employment offices. Some states also tap commercial sources, such as *info*USA Inc. They then screen the data to see whether a taxpayer's income and spending patt match what is reported on returns.

But a few states, such as Texas building more sophisticated data mi programs that will predict taxpaye havior, much as credit-card compa try to estimate how much consu will spend over the course of a year. capability is there to figure out w taxpayers have the highest probabili becoming noncompliant," says Stev Taylor, director of the revenue and pliance team of the data warehou firm Teradata, a unit of NCR Corp.

Iowa, Massachusetts, and Virgini also in the data mining vanguard. cally, each state revenue agency work with one data management pany and its subcontractors, dra from a list that includes Teradata, enue Solutions Inc. of Pembroke, M and CGI Group Inc. of Montreal. data miners can construct pow programs that assign each taxpaye equivalent of a credit score, flag those who should be targeted for a dit. They can project who is likely t on time, who won't pay until they visit from a collection agent, and who is likely to declare bankrupt fore paying their taxes.

For years data mining was too e sive and complicated for states t dertake. But costs have come down the processing and storage capaci the hardware is much greater. A same time, the latest programs users to search multiple datab without having to move ma amounts of information from one puter to another.

The programs work like this: agency may decide to search state ployment records to learn how workers a pizza restaurant has hir then matches tax return inform against that of other, similar-size parlors in the same Zip Code. software is now able to figure ou the shop ought to be reporting

THE STAT

$350+ billion

The gap between what the feds and states figure they are owed in taxes and wha they actually collect

THE I CAN'T DEAL WITH ALL THIS DATA ERA IS OVER.

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$500,000 in sales. If it is not, the business may be an audit candidate.

The analysis can go even deeper. It can match sales-tax payments from the restaurant with the personal tax return of the owner. It can also check state motor vehicle registrations to see what cars the pizza guy owns. If the pieces don't add up, the auditors may pay him a visit.

So far, states have avoided routinely searching bank and credit-card databases, fearing a backlash by taxpayers angry at government rooting through their financial records. But eventually, tax agencies may begin to comb through widely available commercial information.

Business purchasing records may be their first stop. "For the next generation, we'll be able to see how many pizza boxes you order," says LeBovidge. "If someone orders 50,000 boxes and says he only sold 3,000 pizzas, they better be able to show me where the other 47,000 boxes went."

"LIKE BIG BROTHER"

THE IRS HAS FALLEN behind the state agencies, although it has used some data mining for specific projects. For instance, in 2003 it hired an outside vendor to scrutinize information on 4,000 credit-card accounts to determine whether people were using the plastic to hide income they were stashing offshore. But IRS officials say the agency is not routinely matching tax information with data from other government sources. The IRS, in fact, is just beginning to tap state tax information.

The blossoming of data mining in tax offices has many privacy experts on edge. "This can be more like Big Brother than legitimate tax collection," says Marc Rotenberg, executive director of the Washington (D.C.)-based Electronic Privacy Information Center. "There has to be oversight."

To calm those concerns, states insist they have built numerous safeguards to protect the detailed personal information they mine. State employees and private vendors are barred from disclosing the data, contractors cannot resell or reuse the info in any way, and taxpayer information is electronically tagged, so anyone who taps into it leaves a record. Even so, politicians and voters must eventually decide how much intrusion they're willing to live with so that individuals and businesses pay what they owe. ■

SHORT SUPPLY
Asbestos suits hav driven some make away from masks

PANDEMICS

A NEW FEAR ABOUT BIRD FLU

Masks could prove vital in an outbreak. Here's why there may not be enough of th

BY LORRAINE WOELLERT

AN EPIDEMIC OF ASbestos lawsuits has felled dozens of U.S. companies and weakened hundreds more over the decades. Now businesses' worst legal malady could help spread a completely new kind of illness: avian flu. Among the outfits struggling to fend off asbestos suits are industrial safety companies, which make cheap, disposable, polypropylene masks. Such "respirators" could play an essential role in containing any outbreak, but in the U.S., they are in ominously short supply.

Since 2002, mask makers have been targeted by workers seeking redress for lung ailments caused by exposure to asbestos and silica. More than 30 lawsuits in state courts across the try claim that masks worn by indu workers didn't protect them from i ing tiny, potentially deadly airborn ticles. Defendants, ranging from i try giant 3M Co. to a clutch of c held manufacturers, say the respi aren't designed for use in certain i trial settings, such as steel mills o ing sandblasting, a claim backed b eral safety regulators.

Courts have dismissed thousar the complaints, but companies spent millions of dollars defendi settling tens of thousands more. In one of those manufacturers, Pittsb based Mine Safety Appliances Co cided that it had had enough. "W pulled the trigger" and stopped m

meet the CEO of the SKU

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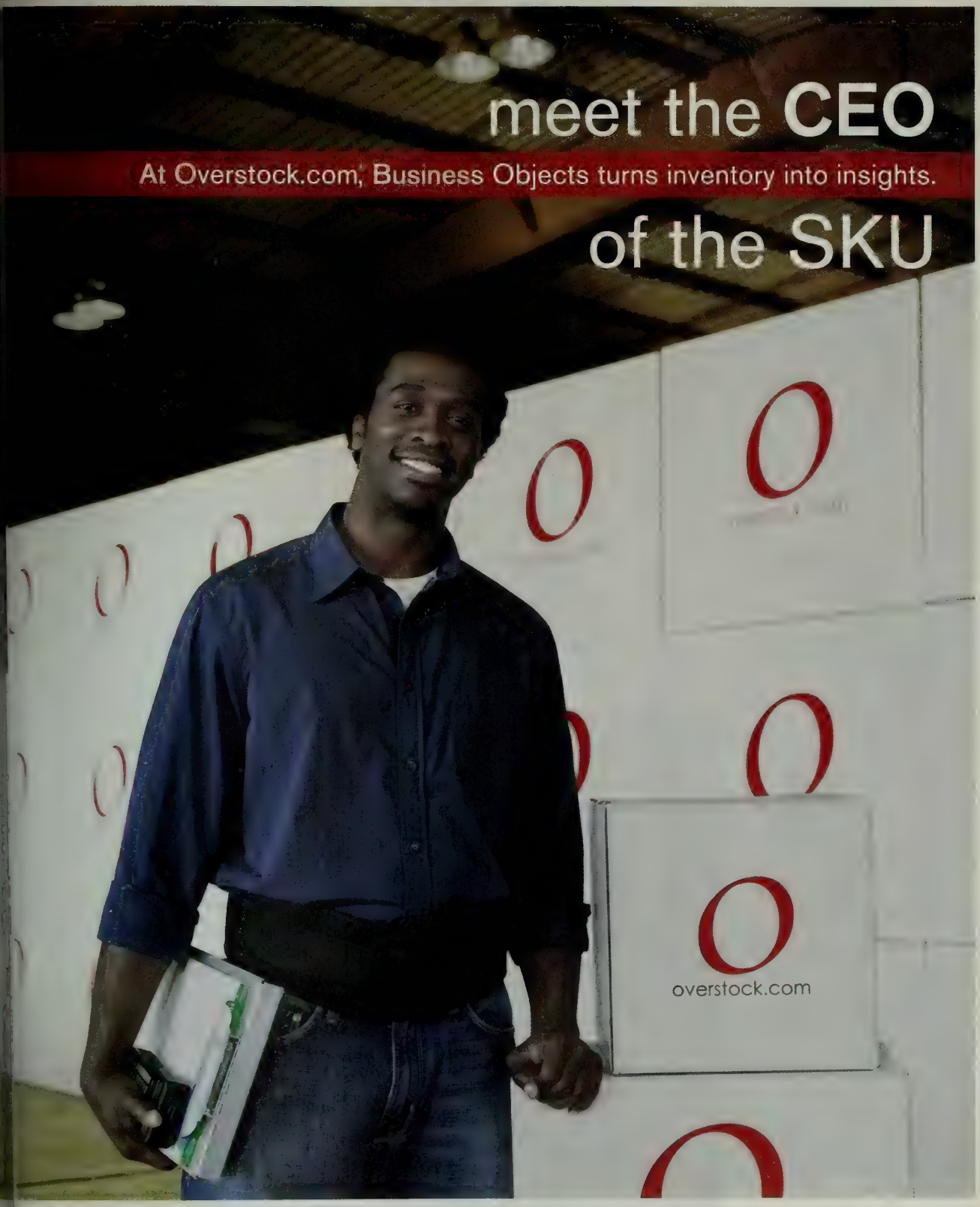

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the masks, says William Berner, the company's risk manager. "There was just too much liability."

Now the mask industry is playing up avian flu worries. The goal is to press Congress for legislation that would insulate companies from lawsuits as long as their masks aren't defective and meet the strict standards set by the National Institute for Occupational Safety & Health. That would effectively shield respirator makers from nearly all litigation, given that NIOSH must approve every type of mask before it's allowed on the market. The proposal has support from Senators John Cornyn (R-Tex.) and Ben Nelson (D-Neb.), but with Congress embroiled in immigration and other hot election-year issues, the legislation has drawn no other co-sponsors and its chances are iffy.

CRITICAL EQUIPMENT

PLAINTIFFS' LAWYERS say malfunctioning masks aren't the problem. They contend that manufacturers improperly marketed the disposable, paper-like face masks to workers and employers as a cheap and safe alternative to much more expensive equipment. "It's not that the products were defective per se," says Brent Coon of Brent Coon & Associates in Beaumont, Tex., a law firm representing organized labor in thousands of respirator cases. The manufacturers "sold them and represented them to be something they weren't."

Mask makers are counting on Washington's support. An industry coalition reports that its members, which represent about 50% of the respirator market, spent the equivalent of 90% of their 2004 net income fighting litigation in the past few years. Even 3M of St. Paul, Minn., is feeling the pain. In the second quarter of 2005, it boosted its respirator liability reserves by $30 million, for a yearend total of $210 million.

Merits of the cases aside, mask production is cooling just as demand spikes. If the nation is hit with a flu pandemic that resists drug treatment, respirators would be one of very few ways to reduce transmission. The fluid-resistant disposable masks, which sell for less than $1 each, could be critical equipment for health-care workers. Replacing the respirators at a steady clip, they would be able to treat patients with less risk of infecting themselves or others.

In early April, the Health & Human Services Dept. said it would pay $34.8 million to buy some 62 million respirators to stockpile for use in the event of a pandemic or bioterrorism attack. Michael Bell, a doctor in the National Center for Infectious Diseases at the Centers for Disease Control and Prevention, says there's no guarantee the masks will help, but he calls the move a precaution. "Our industry partners were telling us they're having difficulty ensuring supply down the road," says Bell. "We were worried that we might be caught short."

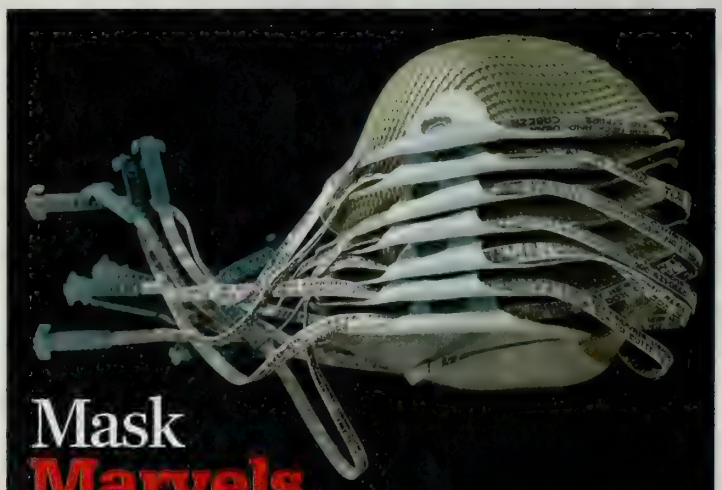
The global rush on respirators is, well, breathtaking. In January, the French government announced a 2½-year plan to acquire 685 million masks, requiring that most of them be mad France. The French gov ment says it will in about $12 million to automate the winning ders' factories. Fr "wanted to have this ca ity within its borders," Jerry McGurkin, se vice-president of Ba Dalloz, an industrial s company near Paris won some of the Fr government's work. Germany, Austr and other countries also are orde masks by the millions.

The cheap devices are one of the few ways to reduce flu transmission

Many companies are ramping up U.S. production. But if a pandemic curs, the U.S. might not be able to overseas for help. When SARS hit C in 2003, Beijing quickly embargoe domestically made masks. "We had ple calling us from Asia crying on phone," says Gwilym McGrew, presi and CEO of AllHeart.com, a medical ply distributor based in Camarillo, AllHeart.com ran out of respirators and has them on back order now as Grew scouts for new suppliers.

The big governmen mand has left hosp fire departments, and c first responders in lurch. When the Balti City Fire Dept. went s ping for 100,000 res tors in March, it cam empty-handed. The believes it finally has f a supplier, but other departments haven't so lucky. "There are s ages around the cour says Dr. Georges C. jamin, executive direct the American P Health Assn., a Wash ton trade group.

"I'm not sure this demic will ever come if it does, the world not have masks," AllHeart.com's McG "When the first spa dies in the U.S. from flu, consumers are g to hoard these thing crazy." McGrew hi is putting some away favor to an emp whose daughter is a atrician. "We have serve set aside for he says. ■



Mask Marvels

Protective masks known as N95 respirators may allow health-care workers to treat flu victims without getting sick or spreading the disease. The government certifies the following specs:

- Fitted properly to the face, N95 masks are able to filter out 95% or more of all particles measuring 0.3 microns or larger. That's sufficient to block the minuscule viruses that cause influenza, hepatitis, and smallpox.
- The masks can handle an airflow rate of 85 liters per minute, equivalent to a person running 10 mph.
- The masks are resistant to fluids but get gummed up by oil.

Data: National Institute for Occupational Safety & Health, Coalition for Breathing Safety

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E-COMMERCE

EBAY'S BID FOR IMPATIENT SHOPPERS

In a grab for broader markets, its eBay Express lets buyers pay fixed prices—fast

BY ROBERT D. HOF

EBAY INC. COUNTS SOME 72 million active shoppers worldwide on its Web marketplace, but Elizabeth R. Scheuring isn't one of them. The co-founder of ThreeForty Communications, a Sausalito (Calif.)-based marketing communications firm, stopped buying on eBay in 2002 to avoid a time-consuming payment registration process. She also didn't like auctions, which can take a week to close. "I have a finite amount of time to get what I need," she says. "I'd be more inclined to use eBay if it were quicker."

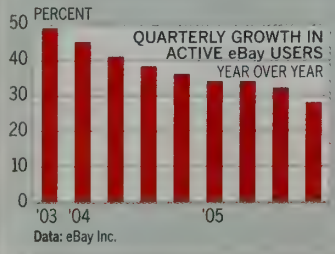
Scheuring will soon get her wish. By late April, the company best known for its online auctions is expected to launch an entirely new e-commerce site for busy consumers who just want to click and buy. Already, eBay offers fixed-price goods from individuals, small businesses, and retailers. But they're scattered among auction search results and elsewhere. EBay Express will aggregate those fixed-price listings in a snazzy, picture-rich design quite unlike eBay's plain-vanilla lists. Available via a link from eBay.com, the new service will be more like Amazon.com and other online retail sites, offering largely new merchandise ranging from books and DVDs to apparel and electronics. Customers will pay with a credit card or an account with eBay's PayPal online payment unit.

As a sort of eBay's Greatest Hits, this is eBay's most aggressive grab for mainstream commerce. It's also a tacit admission that eBay must find ways to fight growing competition, especially from search sites such as Google Inc. "We're seeing search becoming the place where e-commerce starts," says Chris Saito, senior director for search service Yahoo! Shopping. Then there's Google Base, a free listing service that lets anyone offer products fo

All that comes on the heels of a down in eBay's core auction bus The growth of active users als slowed. In the fourth quarter of 200 number jumped 49% vs. the same q a year earlier, but by the final qua 2005 those users had risen 28% pared with the 2004 fourth q (chart). True, profits and sales still s ed ahead last year at a 39% clip, t billion and $4.6 billion, respectivel investors worried about eBay's g prospects have knocked the stock 13% since Jan. 1, to about $38.50.

GOING ONCE...

The launch of eBay Express reflects the parent company's need to find new customers



"A BIT OVERDUE"

EBAY EXPRESS won't single-har recharge growth. But it could get e users to buy a wider range of pro What's more, William C. Cobb, pre of eBay North America, said at a online meeting with eBay mer "We're going to try to attract buye yond our existing base." Currently, tial buyers can't easily find new go fixed prices among the 78 millio listings, they don't want to mess wit tions, or they're wary of small mer

The new site is intended to fix a Selected automatically from milli eBay's existing fixed-price listing products may prove easier to find to eBay's new search technology. T fraud concerns, the site will list pr only from merchants with 98%-plu itive customer ratings on at lea transactions. "EBay Express coul up eBay to a whole new audience it reached before," says Scot Wingo, ChannelAdvisor Corp., which help chants sell on eBay and other sites

Some eBay sellers have high ho eBay Express. "It is a great new se bit overdue, in fact," says Mark F ald, chief operating officer of Grap hill Inc. The company sold $25 worth of shoes and handbags last y eBay, its own si other online m places. Fitz hopes with littl work on his eBay Express boost his sales least 10% on marketing can rolls out this fa en eBay's lin image as a fle ket, a big ad pu be key to gettir cent shoppers it a second lool

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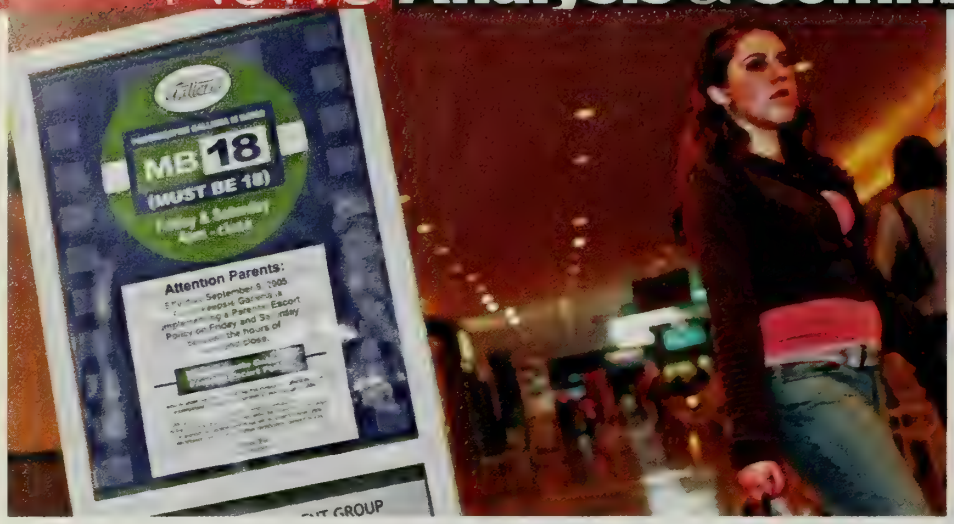

POUGHKEEPSIE, N.Y. At the Galleria, kids must be 18 to shop unsupervised on weekend nights

RETAIL

KICK OUT THE KIDS, BRING IN THE SALES

As malls ban unchaperoned teens in the evening, shoppers are returning

BY LOUISE LEE

EVERY AFTERNOON JUST before 5 p.m., the Fairlane Town Center in the middle-class suburb of Dearborn, Mich., broadcasts a pointed message over the PA system. In English, Arabic, and Spanish, the mall tells all unchaperoned teenagers: Please leave.

Bad for business? Hardly. Two years after instituting its adult supervision policy, under which teens age 17 and below need a chaperone after 5, Fairlane has found that shutting out the big-spending teen demographic is good for business. Families and older consumers scared off in the past by throngs of rowdy teens are coming back. Shoplifting is down, and sales inched up 1% in 2005 after remaining flat the previous year. Most notably, sales at youth-oriented stores grew a healthy 3% to 5%. "The teens that come are now here to shop," says Catherine O'Malley, Fairlane's general manager. "All our tenants enjoy the benefits."

The number of malls with adult supervision policies is small but rising. In a 2005 survey of its 1,000 members, the International Council of Shopping Centers found that out of 120 responses, almost a third had teen rules, most of which were instituted in the last two years. In the past year, Pheasant Lane Mall in Nashua, N.H., Town Center at Aurora, Colo., and Poughkeepsie (N.Y.) Galleria have all adopted rules. Even the Mall of America in Bloomington, Minn., the nation's largest, just last fall tightened its decade-old weekend policy so it kicks in at 4 p.m., two hours earlier than before.

Adopting a chaperone policy comes with real risks, such as alienating a demographic spent $158 bi last year. And rights groups ry that the pol could have a criminatory effect.

Indeed, some malls put in the only as a last resort. In late 2004, to manage the 200 to 300 teens comi the Poughkeepsie mall on a typical F night, general manager Joseph Cas first tried bumping up his staff of sec guards from seven to 10. Then he a off-duty police officers. But problems sisted, and the mall was losing bus on weekend nights as adult custo fled, says Castaldo. After the Septe start of a teen policy on weekend ni incidents requiring police interve dropped from three per night to nor

STILL SPENDING

WHEN O'MALLEY started workir Fairlane in 2003, she too was t aback by the number of teens lounged around, bothering other tomers by blocking entrances, run into strollers, arguing, or cursing. typical weekend night as many as 5 teens came to Fairlane, which ha tenants, including five anchor s and a 21-screen cinema. "Families adults after 5 p.m. would disappear they knew the kids were coming, says. To win support for a teen p O'Malley invited school officials, civil rights groups, and religious le to the mall so they could observ thousands of loitering kids.

Since Fairlane's policy took effe June, 2004, the mall has become ca Membership in its Kids Club, whic ganizes activities for children age 1 under, has tripled, to 9,000, as paren more comfortable at the mall. The "walking club," made up of mostly s citizens, has seen its ranks more than ble, to 1,100. And both parents of yo children and seniors tend to spend n at the mall. Before the policy, at tim to 750 teens expelled a night. number fell to 2 all of 2005, and dents needing intervention, fights, fell 70%.

Meanwhile, are still spending the parents by side are more lik buy something themselves, too.

To Ban or **Not** to Ban?

More malls are adopting policies that limit the access of teenagers to stores.

PROS

- Attracts a wider range of customers
- Helps reduce shoplifting
- Cuts down on disruptive incidents, like fights

CONS

- Teen-oriented retailers could balk—as could teens
- Personnel must be hired to enforce the policy
- Legal troubles may surface, perhaps in discrimination suits

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Singapore has a sophisticated VC industry. There are 165 VC and private equity firms managing US$10.8 billion in funds. The Singapore Economic Development Board's (EDB) Startup Enterprise Development Scheme (SEEDS) – a co-financing equity scheme by EDB and third-party investors started five years ago – has funded about 150 enterprises.

With 25,000 international enterprises in one compact location, start-ups can easily find partners to grow their businesses.

Singapore is Asia's least expensive location for start-ups and the fastest to register a business[2]. It also ranks No. 1 for ease of doing business. Last year, a total of 3,908 new high-tech businesses and companies were established in Singapore. Of these, 736 were from overseas.

Conducive Environment for R&D

Companies find Singapore a conducive place to carry out research & development (R&D) and innovation. Talent is key to R&D, and the highly-trained technical manpower is supplemented by research talent from all over the world. Singapore's 98 researchers per 10,000 labour force compares favourably with developed countries such as the U.S. and Japan.

Companies can tap on the extensive capabilities of the 12 research institutes for technology, equipment and talent through various types of collaborative projects. The research foci of these institutes range from IT and microelectronics to new materials and biotechnology. In addition, the universities and polytechnics have strong research and technology capabilities which companies can leverage on.

Singapore's world-class industry clusters are another draw. They can be excellent partners with their in-depth industrial capabilities and testbedding opportunities.

Finally, companies know that the fruits of their R&D – their intellectual property (IP) – are well protected as Singapore has a high degree of respect for IP rights[3].

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Singapore is an ideal place for companies to set up their regional business management control towers, as seen by the 60 per cent of MNCs which have their regional headquarters (HQ) here. Companies can harness the expertise of 4,500 international players and boutique firms which provide professional management services.

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[1] EXCITE (experiment-commercialise-innovate in a testbed experience) provides hard and soft infrastructure to support testbedding projects. It provides plug and play facilities and a pro-innovation regulatory environment.
[2] It takes only 15 minutes to register a business. Cost of global business start-ups as a percentage of income per capita – 1.2% (World Bank 2004)
[3] Political and Economic Risk Consultancy ranked Singapore the best IP protection and enforcement environment in Asia in 2004.

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'ED BY MIKE McNAMEE

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AMON JAVERS

ENATE DEMOCRATIC LEADER HARRY REID HAS HIS WAY, eday a superfast hovering train will whisk tourists from fam- iendly Disneyland to the what-happens-here-stays-here city, Vegas. But so far, the Nevada senator's fascination with mag- : levitation—the futuristic technology that would power the acros the desert at 300 mph—has ged only to levitate a steady stream of y out of the federal budget: $54 mil- ıd counting.

/ others are climbing aboard. The ortation Dept. rejects MagLev for its price tag, which a 2005 study says es the cost of current high-speed rail urfold to ninefold." Even Nevada's senator, Republican John Ensign, ons the value of spending an esti- $12 billion or more on a 269-mile im-to-Vegas train line.

Reid has pressed ahead, earmark- 9 million between 2000 and 2004 inning a $45 mil- ıthorization in last federal trans- ion bill. It's just mall example of ongressional lead- an keep projects nd how difficult it e for reformers to out earmarks— dden pots of cash wmakers tuck into ing bills for fa- projects or con- ıts.

gLev, which uses raction and repul- f powerful magnets to power a train ng inches off the track, enjoyed a urst of federal support in the 1990s. nites praised it as a new and efficient for short-range travel. But since the Bush Administration has not funding for MagLev projects. "The istration believes that the money be better spent on other transporta- eeds," says Steven Kulm, a Federal ıd Administration spokesman.

with Reid's help, MagLev boosters have kept hope alive. So far, they've spent $7 million on preconstruction engineering studies, and they're pushing for Congress to appropriate the $45 million it O.K.'d last year. The California-Nevada Super Speed Train Commission wants to leverage federal dollars with tax-exempt bonds and private equity. It has partnered with American Magline Group, many of whose corporate members—General Atomics, Hirschfeld Steel, and Parsons Transportation Group, among others—would help build the high-speed train.

Backers argue that the project is crucial for the future of transportation. "I don't know if anyone accused President Eisenhower of pork when he created the interstate highway system," says Neil Cummings, president of American Magline. Jim Manley, a spokesman for Reid, says a high-speed train would ease congestion at Las Vegas McCarran International Airport. "It's a good project," says Manley.

OFF THE GROUND
A MagLev test train in Munich

Nonsense, says Keith Ashdown, vice-president of Taxpayers for Common Sense, a group that tries to limit federal spending. MagLev is "a train to nowhere," says Ashdown. "We're wasting tens of millions of dollars on a project that nobody believes will be built except Harry Reid."

But Reid's faith in MagLev has been a plus for him: Companies and individuals tied to the project have given him $28,749 in campaign funds since 1999, according to the Center for Responsive Politics. And with Ensign facing his first reelection campaign, MagLev fans are opening their checkbooks for him, to the tune of $23,248. For now, MagLev keeps hovering along. ■

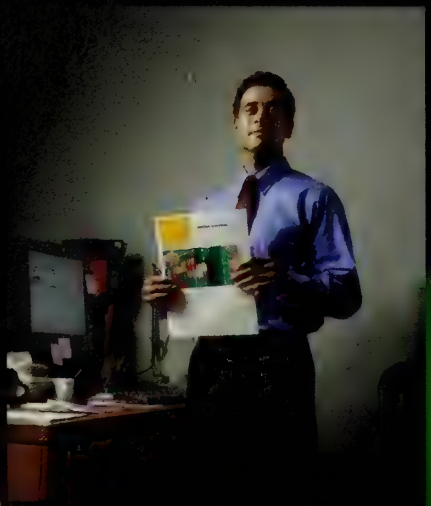
CAPITAL INSIDER

HOW FANNIE CONFOUNDED THE FEDS

How could embattled housing finance giant Fannie Mae hide more than $11 billion in losses under the watch of federal regulators? At the peak of its power, Fannie used lobbyists to bludgeon critics and head off close scrutiny. When the Office of Federal Housing Enterprise Oversight ramped up its oversight of Fannie, the lobbyists persuaded lawmakers to request six separate investigations into the agency. In one, Senator Christopher Bond (R-Mo.) directed the inspector general of the Housing & Urban Development Dept. to see whether OFHEO's investigators unfairly targeted Fannie. No charges resulted. In a report due out in late April, OFHEO will blast Fannie's board, saying directors knew more about Fannie's bad books than previous investigations recognized, including the board-sponsored exam by former Senator Warren Rudman.

BIG PHARMA'S BIG LOBBYING

Washington isn't the only lobbying battleground for hard-pressed drugmakers. Big Pharma spent more than $44 million lobbying against state legislation and initiatives to limit the price of prescriptions in 2003 and 2004, according to the Center for Public Integrity, which tracks political spending. State health programs, including Medicaid, fund about 16% of U.S. drug purchases, the group says. Its study also found more than $8 million in industry giving to state politicians. A spokesman for the Pharmaceutical Research & Manufacturers of America says the group tries to "educate" states "on the unintended consequences of ill-advised proposals."



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INDIA

OPEN SEASON ON OUTSOURCERS

More Western giants are snapping up Indian companies that specialize in back-office operations

BY MANJEET KRIPALANI

TWO YEARS AGO, MANY had written off tech services company Electronic Data Systems Corp. The Plano (Tex.) company had lost top clients because it lacked low-cost offshore capabilities, it faced deep financial trouble, and employee turnover was growing. Some even speculated that EDS might be taken out by an upstart outsourcer from India. But the company restructured, sacked its chief executive, and sold off noncore businesses. Now, instead of the hunted, it has become a hunter. On Apr. 3, EDS offered $380 million for 52% of MphasiS, a Bangalore software and back-office services company. If the deal goes through, EDS's staff in India will grow from 3,000 to 11,000. "MphasiS helps us play offensively in the markets we serve," says Stephen Heidt, an EDS vice-president. "It offers us capabilities that otherwise we'd have to develop ourselves."

Plenty of Western software and services companies are coming to a similar conclusion. On Mar. 20, Chicago printing giant R.R. Donnelley & Sons, which has its own 2,000-employee back-office processing unit in India and Sri Lanka, acquired OfficeTiger LLC, a hot Indian analytics and accounting outsourcer, for $250 million. And last year, software house Oracle Corp. paid $900 million for 61% of iflex solutions, a banking software company based in Bombay. "With outsourcing going mainstream worldwide, Western companies that want a global presence will be looking to acquire an India operation," says Sujay Chohan, researcher director for Gartner India.

INDIAN SUITORS

THE INDUSTRY EXPECTS all sorts of deals in coming months. IBM, Capgemini, and electronics manufacturing and design giant Flextronics have been scoping out potential targets, insiders say. And many Indian companies are looking for a marketing presence in the West in order to grow, while some of the country's early outsourcing entrepreneurs are ready to cash out, which will likely create new buying opportunities. Dozens of small and midsize outfits in India might prove attractive to the industry's giants. Second-tier Indian companies such as Polaris Software Lab, Hexaware Technologies, Zensar Technologies, and Patni Com er Systems, and niche players like tele software maker Sasken Communica Technologies and back-office prov EXL Service and Datamatics coul prime targets. Even some bigger o could be in play. Bombay's WNS G Services, a $200 million-plus com that specializes in clerical work for t and insurance companies, is plannin initial public offering this year, but c also end up being taken over. "Eithe are a billion-dollar business, or a 1 smart company, or you're up for gr says Sunil Mehta, vice-president of ware association Nasscom.

The dealmaking is part of a bro consolidation of the info tech service dustry. On Apr. 4, for instance, El Se do (Calif.)-based Computer Scie Corp. (CSC) announced it was puttin self up for sale after struggling to re expenses. Providers need huge scale low costs to compete fo multiyear, $1 billion outsourcing contracts n nationals are offering i eas such as accounting man resources, research. In recent year dustry leaders such as Accenture, and Hew Packard have add-ed t sands of workers in I but other players fail see the opportunity. IBI instance, three years bought New Delhi call ter operator Daksh for million, and now 38,500 employees in I "We started late in ter

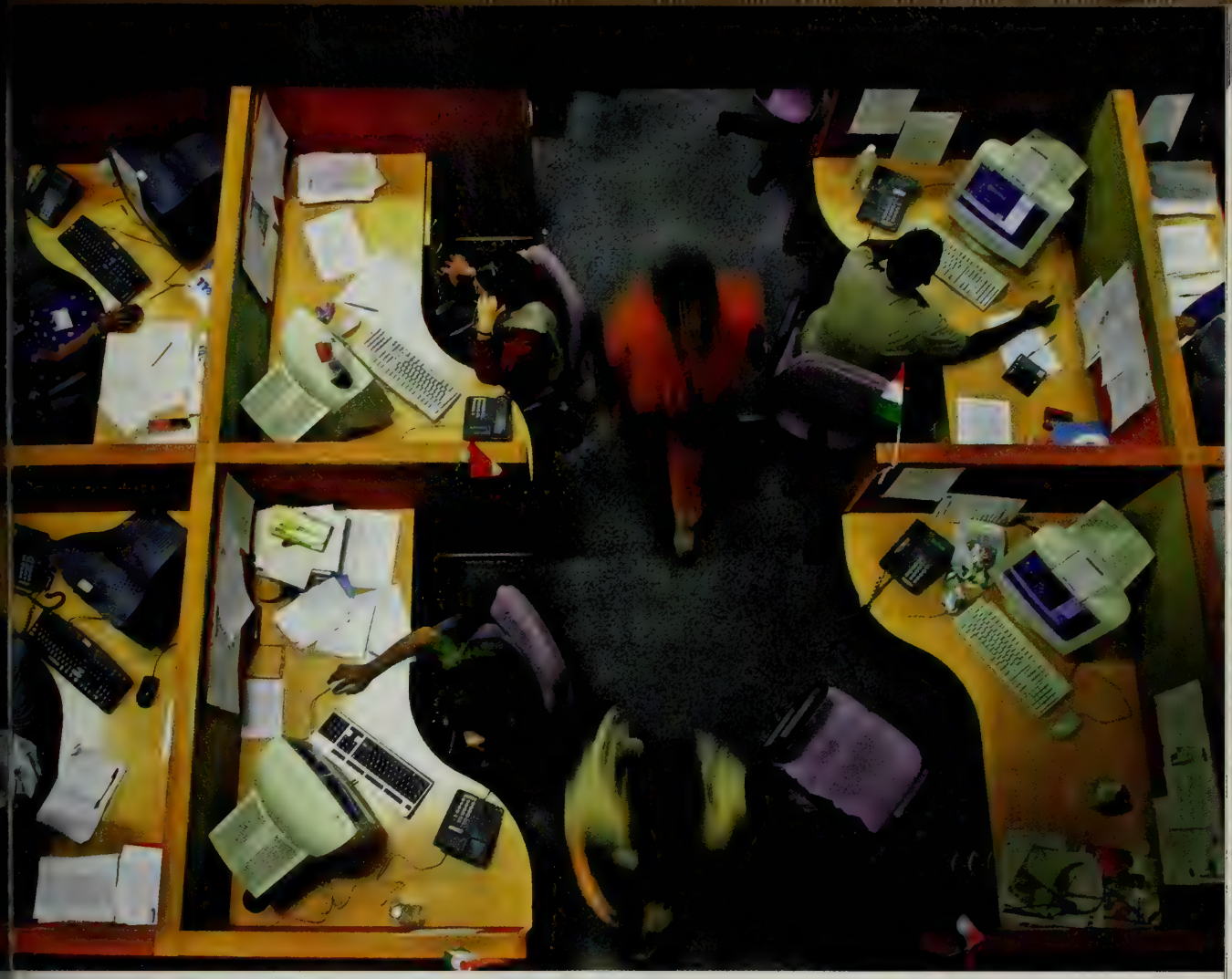
Ripe for the Picking?

Potential targets as India's outsourcing industry consolidates

COMPANY	REVENUES* (MILLIONS)	EMPLOYEES	FOCUS
Patni Computer	$450	12,000	Tech services and clerical work for banks, retailers, and airlines
Polaris Software	177	5,900	Software and clerical work for financial-services firms
Hexaware	154	3,700	Back-office work for banks, airlines, and insurers
Mastek	130	2,800	Software development for financial-services companies
Zensar	77	2,500	Software and financial-services back-office work

*Most recent fiscal year

Data: Company reports, Bloomberg Financial Markets



SIS The EDS
arked a rise
Bangalore
any's stock

leveraging capabilities in India, but others were even slower," says Amitabh Ray, business consulting chief. "EDS, nd others are just getting started."

eigners won't be the only ones buy-enpact, the world's largest offshore office player, which is 40%-owned neral Electric Co. but headquartered w Delhi, could benefit from acquir-company such as WNS to diversify ent base since it currently gets 85% work from GE. Homegrown cham-such as Infosys, TCS, and Wipro kely want to bulk up further and are g acquisitions in the West to better ete against multinationals. They're ng the heat from the aggressive ex-on of global rivals like IBM into In-says Sudin Apte, country head of ster Research Inc. in India.

IIUM PRICES?

CONCERN WILL be price. The Indi-ck market has jumped from one l high to another this year as in-s seek to cash in on the country's tial growth. Infosys, for instance, is trading at more than 35 times its expected 2006 earnings, and MphasiS' stock has shot up 15% in the past month alone. Some dismiss such valuations as unjustifiable, but the pressure to get an offshore presence in India is so great that Western companies might seize the opportunity now and pay such high multiples for fear of finding themselves out of the running.

About $70 billion in business is up for grabs over the next two years

It seems there will be no shortage of potential work. About $70 billion worth of outsourcing contracts will be up for renewal over the next two years, and billions more in new contracts will be signed, according to Forrester. And the range of activities that companies are willing to ship offshore is growing. "The back-office processing space is wide open," says Sid Khanna, Accenture's global partner for outsourcing. "Many areas like legal outsourcing and architecture back-office work are in their infancy and will make good, solid businesses."

The EDS deal will give MphasiS a global partner that can market its services worldwide. The company, an early entrant in the business, has been struggling lately due to lack of a strong overseas presence, high attrition, and tensions between large investors, leaving MphasiS far behind larger rivals such as TCS and Wipro. EDS, meanwhile, will benefit from the Indian company's lower cost structure and its expertise in finance and accounting. And Heidt, the EDS vice-president, says MphasiS may be just the beginning. The Texas company has only 3,000 workers in India without counting MphasiS. But Heidt says EDS had planned to double that number this year, and ultimately may end up with 20% of its global workforce of 120,000 outside of the U.S., a goal that could be met either by organic growth or acquisition. "We continue to look for stuff that fits our needs," Heidt says.

Others surely will do the same. And increasingly, the stars of the global outsourcing industry are likely to find that fit with companies in India. ■

–With Steve Hamm in New York

RARIN' TO GO The new TT hardtop coupe before its Apr. 6 unveiling

GERMANY

AUDI: LOOKING FOR TRACTION IN THE U.S.

The carmaker is counting on new models to replicate its success at home

BY GAIL EDMONDSON

THE BUZZ AROUND AUDI'S new TT was growing even before the sports car was set to have its glitzy unveiling beneath Berlin's Brandenburg Gate on Apr. 6. Across the Atlantic, Tracie Dean, general manager of Jim Ellis Audi of Atlanta, says customers have been showing up for weeks to put cash down for both the TT, priced around $35,000, and the $50,000 Q7 SUV. "People are just dying to get them," she says.

The question is, how many? For decades, Audi has taken a backseat in the U.S. to the more established Mercedes-Benz, BMW, and, more recently, Lexus nameplates. Yet Audi has been enjoying roaring success in Europe, where it sells nearly as many cars as BMW. With European high-end consumers snatching up everything from its A3 compacts to its luxury A6 sedans, the Bavarian carmaker earned a pretax profit of $1.6 billion, up 14.6%, and revenues rose 8.5%, to $32 billion.

Audi's Achilles' heel, however, remains the huge North American luxury market, where it still needs to overhaul its network of dealerships and polish service and quality to better compete with BMW and Mercedes. So far this year, Audi has sold fewer than 18,000 cars in the U.S., vs. more than 63,000 sold by BMW, according to Autodata Corp., a Woodcliff Lake (N.J.) market research firm. "Audi is still rebuilding its brand image" in the U.S., says George Peterson, president of AutoPacific in Southfield, Mich. "BMW has been the picture of marketing consistency since 1977."

To close the gap, Audi Chief Executive Officer Martin Winterkorn is counting on not just the TT Q7 but at least eight other new models will come to market over the next years, including a much awaited high luxury sports coupe called the R8. He's behind a push to upgrade dealerships urban centers, from Miami to San Fra co, and split them off from the sh showrooms with the more prosaic V wagen. Quality is on the mend, too. year, Audi ranked eighth in J.D. Pow Associates Inc.'s annual customer surv quality, up from eleventh in 2004.

The new TT, designed by Audi's ian chief designer Walter Maria de'S is surely an attention grabber, wit muscular stance, predatory-loo grill, and elegant lines. Still, it wi hard to top the first-generation which was a smash when it rolled o 1998. The model quickly became a erful image maker for Audi with its geometric design that broke with a motive stereotypes.

BIG-CITY STYLE

THE TT IS ALL ABOUT burnishing Audi brand, but it's the Q7 that cou the most to boost U.S. sales. The seven-seat SUV, built on the same form as the Porsche Cayenne and Volkswagen Touareg, sports clean st and such features as a radar-based w ing system to ease the problem of view-mirror blind spots. Thanks t partly aluminum frame, the Q7 will b most fuel-efficient SUV in its class, ge about 20 mpg. And even if gas prices higher, "for anyone who can afford the price of gasoline is an asterisk," James N. Hall, AutoPacific's vice-p dent for industry analysis.

So far, analysts say, the Q7, which on sale in March in Europe and wi U.S. roads in Ju off to a good Audi expects to 76,000 Q7s in the first full ye production, inclu 35,000 in the U.S

Of course, e thing depends Audi's ability to honing its quality image as it to crank out one hot model another. Although Garel Rhys fessor of automotive econom Cardiff University in Wales, t it would take at least five years not impossible for Audi to BMW" in the U.S. For Audi, th is just beginning. ■

–With Brian Grow in At

No Contest

Vehicles Sold in the U.S.*

AUDI	BMW
17,884	63,103

*Year-to-date, through March Data: Autodata Corp.

THE 2007 AUDI Q7 SUV

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MARKETING

SELLING SAKE LIKE SINGLE MALTS

Japan's microbrewers are out to sell Americans on the good stuff

KYOTO CEREMO
Sake consump
in Japan is hal
postwar peak

BY KENJI HALL

AT THE FOOT OF THE Japanese Alps northwest of Tokyo, the rice polishing machines at sake producer Miyasaka Brewing Co. have fallen silent for the season. All but a few fermentation vats sit empty, and most of the white-clad workers, who spend the chilly winter months making Japan's traditional rice wine, have gone home to tend to their farms.

But one thing at this 340-year-old family-run business is still going full tilt: the marketing machine. As sake consumption in Japan evaporates, Miyasaka is busy trying to drum up new drinkers. "It's a very dark period for small brewers," says 50-year-old Managing Director Naotaka Miyasaka.

Miyasaka isn't the only small-time sake brewer who's hurting. For years, Japanese have been abandoning the national drink in favor of beer, imported wine, and shochu, a homegrown liquor. In the year ended Mar. 30, 2005, sake consumption fell to 826 million liters, 7% below the previous year, and half its postwar peak in 1976, Japan's National Tax Agency says.

JAPAN MANIA

TO STAY AFLOAT, Miyasaka and many of Japan's 2,000 other producers are aiming to sell their prizewinning bottles across the Pacific. Although sake isn't exactly new to the U.S., the market has long been dominated by industrial-size brewers that flood stores and restaurants with cheap swill best drunk hot to cover up its rough edges.

Now small and midsize breweries are taking a different tack. They're playing up the labor-intensive, artisanal traditions of their *jizake*, or microbrews, and trotting out their top-of-the-line bottles for Americans. Made from fermented rice, sake is slightly more potent than wine, packing an alcohol content of 15% to 18%. And the oldest breweries rely on techniques honed over centuries, such as mixing the rice and *koji* (a special mold) by hand. Award-winning bottles can have flavors and aromas as complex as Bordeaux or Burgundies, and aficionados describe them with wine-like terms such as nutty, crisp, light, and dry. "Good sake does a good job of selling itself," says Chris Pearce, president of Honolulu's World Sake Imports LLC.

Well, sort of. Last year, exports to the U.S. hit nearly 3 million liters, up from 1.8 million in 2000, according to Japan's Finance Ministry, and this year looks strong, too. But those levels are still a drop in the cask: less than 1% of Japan's annual sake production and about a third of what Japanese brewers produce in the U.S. Even so, there are signs that premium brands are making inroads. sake exports to the U.S. were a modes million last year, that was nearly d their level in 2002. And the average per bottle has risen to around $13, up about half that a decade ago.

Sake is riding a wave of Japan n In San Francisco and New York, w and miso have gone mainstream sake is even featured on the me some French and Italian restau "Sake is chic," says Kevin Hyland, tender at Haru, a New York Asian restaurant that serves "saketinis" a as high-end bottles that can go much as $130 a pop.

So Miyasaka keeps pushing his overseas. Although exports represe 4% of his $15.5 million in annua enues today, he predicts they coul day be a fifth of sales. To boost his at home and abroad, he is studyin marketing techniques of wine prod devising new bottle shapes, renowned calligraphers to design and giving sake seminars to waiter Miyasaka has taken a page from wi in France and California: At the fr his old, low-slung wooden warehou has set up a gift shop offering apro shirts, and—of course—bottles of s

–With Hiroko Tashiro in

A Sake Lexicon

DAIGINJO-SHU Sake brewed from rice milled to no more than half its original size, giving it a refined, fruity taste.

GINJO-SHU Brewed from rice milled to 60% or less of its original grain, which makes for a light flavor and fragrance.

HONJOZO-SHU Sake with distilled alcohol added to create a milder flavor. Brewers started adding extra alcohol to sake during World War II.

JIZAKE Sake from smaller *kura*, or breweries. Connoisseurs rave about the distinctive flavors of high-end *jizake*.

JUNMAI-SHU Sake brewed with only rice, water, yeast, and *koji*, or mold. It tends to be heavier and more acidic than *honjozo-shu*.

Data: Sake-world.com, *BusinessWeek*

ENERGY FOR THE 21ST CENTURY

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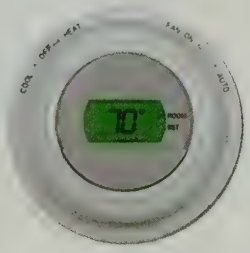

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The Mind Games Cybercrooks Play

They're exploiting psychological vulnerabilities to gain access to your data

BY BRIAN GROW

THE SUBJECT LINE IN AN e-mail that hit thousands of in-boxes around the world last month reads, "lawsuit against you." In flawless legalese, the message warns recipients that they recently sent an unsolicited fax to the sender's office. Citing U.S. civil code, its prohibition on sending junk faxes, and an actual $11 million settlement by restaurant chain Hooters, the missive threatens a lawsuit over the alleged junk fax. "If you do not pay me $500 by the deadline for payment, I intend to sue you for violating the Telephone Consumer Protection Act," it reads. "If you force me to sue, I will not settle for less than $1,000." Details of the alleged lawsuit are contained in the e-mail's attached document.

PSYCHED OUT

IN TODAY'S LITIGIOUS—and digital—society, being notified of a lawsuit via e-mail might not seem too unusual, right? Gotcha! The e-mail is a scam that preys on deep-seated fears of being hauled into court. Its target: unlucky recipients who may indeed be among thousands of individuals and companies that send junk faxes. The attachment—labeled lawsuit.exe—contains a new variant of a computer worm called Bagle. When worried victims open the attachment, malicious code embedded in its text downloads onto their PCs and swiftly harvests all their e-mail addresses to send out even more spam. That second wave uses the victim's personal e-mail address to send malicious code disguised as, say, a pitch for a Paris Hilton sex video, to friends and associates. "This is one of the most innovative ideas used by spammers to target unsuspecting users," says Govind Rammurthy, chief executive of computer security firm MicroWorld Technologies Inc., which sent out a warning about the lawsuit.exe scam in March.

With sneakier hackers, fraud losses are climbing

As Web-based scams proliferate, it's often psychological cunning, deployed on top of surreptitious code, that is the secret to cybercriminals' success. Like con men on the street devising new tricks, Internet fraudsters need a never-ending supply of ways to persuade victims to open an attachment, click on a link, or innocently enter personal data on a Web page. Bypassing mental barriers, rather than software firewalls, is the surest means, say analysts, to pickpocket personal identities and online bank accounts. "You can't install a software patch for a person's mind," says Barry C. Collin, chief executive of cybersecurity consulting firm Threat & Risk Associates.

In fact, hackers spend serious effort to research the psychological vulnera ties of potential targets, accordin data-security analysts. They watch r headlines for emotional or worris world events and often review the cess of an attack by reading press re es and corporate warnings in ord tweak the next attack for greater e tiveness, says security firm Trend M Inc.'s director of global education, D Perry. Analysts say "phishing" att often spike after a data security br makes headlines. The reason: tomers are already anticipating a p tial request to update account data monitor their credit reports.

A scam involving Citibank earlie year shows how far tricksters will go their mind games. To trust, it operates in two p es, say analysts. First e-mail purportedly Citibank warns that custo accounts may have been promised in a previous s But it doesn't ask for per information. Instead, scam requests an e-mai dress, just in case the vic account is found to be ha Later, a second messa sent out warning that, in the account has been con mised. That message quests an update of the tim's financial details. "' was built in the first Then, in the second step asked for confidential i mation," explains M World's Rammurthy. He mates that some 60 victims who received the ond e-mail provided per and financial data.

Indeed, with overal turns from phishing at falling as people grow wary of them, Web crim are finding novel ways to suade users to open ments or click links download data-stealing software PCs. Instead of directly asking the u enter personal data into a fake Wel cybercriminals are embedding cod fake news articles or business-ori "requests for proposals." When op they install a back door into the PC record and transmit the user's strokes—including sensitive inform such as names and passwords.

The upshot: Fewer people are cou up personal info, but fraud losses cor

EN THE INFORMATION NEVER STOPS, NOTHING CAN STOP YOUR BUSINESS.

iness, keeping people and information connected is critical to g customers satisfied. And yet, at any given moment, any r of events can easily derail that connection. That's why you company like SunGard on your side. Our Information Availability ns provide redundant systems and networks at over 60 secure es worldwide to make sure your customers, employees and rs stay connected 24/7. And at the same time keep your IT staff plete control of your data and applications. So while you're busy g your business, we're busy making sure your business is up and g. No matter what.

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Citigroup:

• America's Most Admired Companies 2003 - Financial Industry: No.1 Megabank 2002/03 • Most Profitable Company 2002 • Biggest Company by Equity 2002 • Largest Commercial Bank 2002 *(Fortune)* • Forbes 2000 List for 2003 – The World's Leading Companies: No.1, and World's Biggest Assets Holder • Forbes 2000 List for 2004 – The World's Leading Companies: No.1, and World's Biggest Assets Holder • The Global 500 List for 2003 - The World's Largest Public Companies: No.1 • The Global 500 List for 2002 – The World's 500 Biggest Companies: No.1 *(Forbes)* • Top Tier One Capital Bank 2002 • Top Total Assets Bank 2002 • Top Market Capitalization Bank 2002 • No.1 Bank in North America 2002 • No.1 Bank in the World 2002 *(The Banker)* • Best Global Corporate Bank 2003 • Best Bank in North America 2003 • World's Biggest Bank 2002 *(Global Finance)*

George V Hotel, Paris:

• No.1 Hotel in the World • No.1 Hotel among Top 20 International City Hotels - 4 Consecutive Years 2001, 2002, 2003 and 2004 *(Andrew Harper's Hideaway Report)* • Best City Hotel Worldwide 2002, 2003, 2004 and 2005 • Best City Hotel in Europe, Africa, and Middle East 2003, 2004 and 2005 • Best Hotel Group Worldwide – 2005 • Best Hotel/Resort Cuisine 2004 and 2005 –3-Michelin Star Cuisine *(The Gallivanter's Guide)* • Best Luxurious Hotel in the World in 2002-2003 *(L'hotellerie Magazine)* • Best Hotel on the Web 2003 *(Trip Advisor: Best Hotels on the Web)*

News Corporation:

• Most Global Media Company 2002 *(World Screen News)*

Four Seasons Hotels & Resorts:

• Top Hotel Chain in the World 2003 *(Zagat Survey: Top International Hotels, Resorts & Spas)* • Best Hotel Group Worldwide 2004 *(The Gallivanter's Guide)*

The Plaza Hotel:

• Favorite Individual Hotel for Business Travel in North America: Business Traveler Favorite - for the 11th Consecutive Year 2003 *(Business Traveler)*

Kingdom Centre:

• Skyscrapers.com 2002 Award: Best New Skyscraper of the Year for Design and Functionality *(Skyscrapers.com)* • King Abdullah Bin Abdulaziz Mosque on the 77th floor at Kingdom Centre, as the world's highest mosque above ground level *(Guinness World Records 2005, 2006)*

Kingdom Mall:

• ICSC 27th International Design and Development Award - Innovative Design and Construction of a New Project Award 2003 *(ICSC.org)*

Samba Financial Group:

• Best Bank in Saudi Arabia 2000, 2001, 2002 • Best Private Bank in Saudi Arabia 2004 • Best Domestic Bank in Saudi Arabia 2000 • The Best Debt House in Saudi Arabia 2005 *(Euromoney)* • Best Internet Bank in Saudi Arabia 2002, 2003 and 2004 • Best Trade Finance Bank in Saudi Arabia 2001, 2002, 2003 and 2004 • Best Integrated Consumer Bank in Middle East & Africa 2005 • Best Corporate Information Security Initiatives in Middle East & Africa 2005 • Best Corporate Internet Bank in Saudi Arabia 2002, 2003, 2004 & 2005 • Global Best Corporate Online Cash Management Bank 2005 • Best Equity Bank 2005 • Best Foreign Exchange Bank in Saudi Arabia 2002, 2003 *(Global Finance)* • Best Publicly Held Corporation in the Arab Gulf Cooperation Council 2001 *(Stern Stewart & Company)* • Top Bank in the GCC & Levant Region 2003 *(Gulf Banking Consultants' Services)* • Gulf Brands of the Decade Awards Winner 2003 • Brand of the Decade Awards – Banking, Finance & Insurance 2003 *(Gulf Marketing Review)* • Bank of the Year in Saudi Arabia 2000, 2001, 2002 & 2005 *(The Banker)* • Best Online Bank 2004 *(Arabian Business)*

Mövenpick Hotel & Resort Beirut:

• Best Hotel Construction 2002 *(Hermes Award)* • Fastest Growing Hotel Chain in the Middle East 2003 *(Middle East Travel Magazine)*

Sharm El Sheikh Four Seasons Hotel & Resort:

• Hotel of the Year Editor's Choice - 2002 • Best New Hotel 2002 *(The Gallivanter's Guide)*

to climb. A 2005 survey by Gartner Inc. found that just 2.5% of phish recipients responded with personal or financial information, down from 3% in 2004. But fraud losses connected to the theft of such information off the Web rose from $690 million in 2004 to $1.5 billion last year. "If I'm a scammer, I have to do something that will make you trust me," says John Pescatore, vice-president for Internet security at Gartner.

$20 TUTORING

LAW ENFORCEMENT agents say the thinking behind cyberscams is not much more complex than age-old cons run by offline grifters. However, they add, it's clear cybercriminals are pooling their brainpower to devise new techniques. A DVD available in foreign black markets called *Hacker's Handbook* contains scores of tips on how to trick victims, according to Trend Micro's Perry. And former hacker Kevin Mitnick, who now runs his own security consulting firm, has hosted a two-day "social engineering" conference for clients that outlines hackers' techniques and includes a session entitled "Bugs in the Human Hardware."

Scam artists are joining forces to invent new tricks

It's not just the growing ranks of scam-wary Web surfers that have hackers seeking ever more clever techniques. They also have to hustle to stay ahead of an ever more crowded field of competitors. It's becoming easier than ever to get into cybercrime. On Mar. 24, security firm Sophos Inc. said that it had discovered a Russian Web site selling a kit called WebAttacker for less than $20. The software in the kit downloads a program that tries to turn off PC firewalls, then installs a keystroke-logger. Already, WebAttacker has been shot out via spam that promotes news stories about bird flu and the death of former Serbian President Slobodan Milosevic.

The upshot is that increasingly it's psychological cunning, not code-writing skills, that make for a successful hacker. "In order for the cybercrime business to continue, it is going to rely more and more on social engineering," says Ronald J. O'Brien, senior security analyst at Sophos. ■

Thinking Globally, Stuck Locally

Weary of going town to town to get into t TV biz, the Bells want Washington's help

BY SPENCER E. ANTE

LAST SUMMER, PHONE companies turned Indiana into ground zero in their war with cable and satellite providers. Armies of lobbyists for Verizon Communications Inc. and AT&T Inc. descended upon Indianapolis and kvetched about the state of cable television. Having invested billions of dollars to upgrade their communications networks so they were capable of offering TV service, the phone giants wanted a law making it easier to actually offer it.

Their entry into the market has been as slow as a dial-up connection because U.S. law requires them to negotiate so-called franchise agreements with thousands of municipalities, town by town by town, across the U.S. That process can drag on for years. So phone companies are pushing states such as Indiana to let them speed up the process.

HURDLES GALORE

IN JANUARY, AFTER the Indiana legislature introduced a statewide franchising bill, the fight turned nasty. Attack ads funded by the cable industry rained down like hailstones. One, featuring a blonde-haired girl in a field of wildflowers, claimed the bill would "raise our taxes by millions of dollars" and allow the "phone companies to provide video services to only the wealthiest neighborhoods."

The negative blitz didn't work, though. On Feb. 28, the General Assembly passed the bill by a vote of 78 to 18. Governor Mitchell E. Daniels Jr. signed it into law on Mar. 14, boasting that the bill would spark big investments in the state. "In politics, momentum is everything," says AT&T Senior V President James W. Cicconi. "And now there is incredible momentun hind reforming the franchise."

For all the talk about broadband nology and video-content agreem the biggest hurdle to phone comp sending TV into homes has been ge local government approval. Of the franchise negotiations that Verizo working, 107 have been dragging o more than a year, according to a let filed on Mar. 8 with the Federal Com nications Commission.

But after months of spinning wheels, the phone giants are sudd getting traction in their push to ch the franchise laws. Texas and Vir also have passed laws, and similar are pending in close to 10 other st including Florida, New Jersey, and ifornia. Meanwhile, the phone com nies may not even need state help Mar. 28, Representative Joe Barto Tex.), the chairman of the House En & Commerce Committee, introduc bipartisan bill creating a national franchise to let phone companies by states and cities. Analysts see a ch of getting a franchise-focused passed into law this year. That's ur ly, though, if legislation is broaden include such knotty topics as indec

Calling All Congressmen

For months, phone companies have lobbied federal and state officials to cl the way for video service across the U They are starting to see some progres

wireless spectrum allocations. FCC Chairman Kevin J. Martin also has expressed an interest in streamlining the franchise process. On Mar. 28, the FCC extended its reply period for comments on rules designed to promote greater video competition. AT&T and Verizon have proposed that the feds require local officials to act on an application within 30 days. "This is a priority for me," Martin told *BusinessWeek*. "We are trying to make sure we are doing everything we can to facilitate competitive entry."

A lot of lobbying muscle has been focused on the issue. Phone companies are spending up more than ever. Last year they spent a collective $60 million lobbying just at the federal level. The franchise campaign qualifies as the second-biggest lobbying effort in Washington today, trailing only health care, according to the Center for Public Integrity.

CABLE COMPETITION WANTED

COINCIDENTALLY OR NOT, there seems to be an emerging consensus among lawmakers, regulators, and consumer groups that more competition is needed to rein in cable-TV bills, which are still rising at twice the rate of inflation, according to the Consumers Union. Says Jeannine Kenney, a CU senior policy analyst: "We are eager to see the Bells enter the marketplace."

Cable operators respond that phone companies should have to clear the same hurdles to local service that they do. Cable execs also claim that if allowed to bypass antidiscrimination requirements of the franchise laws, the Bells will cherry-pick wealthy neighborhoods, leaving others with fewer choices. In fact, the three states that have passed franchise reform laws are not requiring video franchisees to build out 100% of their markets. In Indiana, they can pick and choose where they wish to provide service. Cable outfits dispute that they don't face competition, noting they already face off against satellite operators. "We welcome the Bells as the fourth or fifth competitor in our markets as we go into their phone markets as the second competitor," says Comcast Corp. Executive Vice-President David L. Cohen.

Some analysts say that if the FCC passes new rules, cable lawyers could tie them up in court for years. "There is no factual basis for any FCC action, nor do we believe they have the authority to make those types of changes," says Brian Dietz, spokesman for the National Cable & Telecommunications Assn.

Verizon, at least, isn't waiting for federal action. It already plans to spend $11 billion between 2005 and 2010 to lay fiber-optic cable, according to estimates by UBS. And in each state that clears aside local franchise requirements, it is moving more quickly to deploy service. "Having an expedited process to get there means we will see better financial numbers sooner," says Verizon's Marilyn O'Connell, senior vice-president for video services. The laws also reduce the chance that Verizon has to pay what O'Connell calls "tributes"—projects and fees that towns demand to obtain a franchise. Verizon has been asked to provide cell or Internet phone service for free, and one town was brazen enough to request a $13 million grant, says O'Connell.

But even if phone companies keep scoring wins on franchising, that won't solve all their challenges with video. Scott Cleland, CEO of research company Precursor, notes that cable operators have "a two- to three-year lead in offering a unified bundle" of phone, video, and Internet services. When phone companies gain access to the living room, they still have to wrestle away the remote.

CONGRESS The recent version of a House bill creates a national franchise, allowing the new companies to bypass local authorities. But because it's nearly impossible to get consensus on broader telecom issues, passage will be difficult.

FCC Federal Communications Commission officials are considering new rules that would make sure municipalities do not unreasonably refuse to award new video franchises.

STATES Three states (Texas, Virginia, and Indiana) have passed laws streamlining the franchise process. Similar bills are pending in other states, including Florida, California, and New Jersey.

DOUGLAS FRASER

J&J: Reinventing How It Invents

The giant bets on a new push for product development as a cure for its ailing stock

BY AMY BARRETT

THESE DAYS, MANAGERS at Johnson & Johnson are willing to look in some unusual places for inspiration. Last year a small unit within J&J's Ethicon Endo-Surgery tools business was brainstorming about how to design a better surgical clip. A team of seven scientists and engineers fanned out to buy as many clips of any type as they could find. They grabbed a motley collection—more than 100 of them—from Wal-Mart Stores, Home Depot, and other local hardware and hobby shops. Those clips now hang on a big board in the group's warehouse-like research and development offices outside Cincinnati. "The idea was to free [the team] up," says Dr. Harlan Weisman, chief science and technology officer for J&J's device and diagnostic unit. "Let them be like kids and maybe they'll come up with a nifty solution."

The shopping spree is just one small example of how the 120-year-old company is trying to drive innovation in its growing, increasingly important medical device business. J&J executives are trying to replicate the fertile and fast-moving venture-capital world, creating internal startups that hunt for financing among other J&J units as they would if they were independent. J&J is also pushing for greater input from doctors and insurers to guarantee that it knows exactly what devices customers will want—and what sort of data they will demand before using them. The company is even tinkering with its much-vaunted decentralized management structure, putting Weisman in his newly created position last fall as a way to bring greater focus to the task of identifying new markets. "It's not your father's Johnson & Johnson," Weisman asserts.

BREAKUP SPECULATION

THERE'S A SENSE OF urgency at the New Brunswick (N.J.) icon. With $16 billion in cash, J&J is on the prowl for sizable acquisitions. But after getting outbid for Guidant Corp. earlier this year, it knows all too well that potential targets won't come cheap. Without a shot in the ar the form of new products, however, e ings growth is expected to make a m downshift. While earnings per s were up an average of 16.2% annu over the past five years, Morgan Sta analyst Glenn Reicin expects an ave of just 8.4% for each of the next five y No surprise, then, that Wall Street been backing away from the compa stock, which fell 13% in the past yea $59 on Apr. 4. Once a premium st J&J is now occasionally the subje breakup speculation.

The health-care giant's record of i nal innovation simply hasn't kept with its increasingly massive size. challenges are particularly worrison J&J's $19 billion devices and diagno business, which represents 38% of ov revenues. Last year that unit fuele company's growth as its big drug o tion slowed. And J&J Chairman and William C. Weldon made it clear wit ill-fated Guidant bid that he was loo to shift the business mix away from p maceuticals, where the entire ind pipeline is weak, and toward devices

That's why Weisman's new job b critical. A rising star at J&J, Weisma came to the company in 1999 with th quisition of biotech Centocor Inc. deal, which brought J&J the blockb rheumatoid arthritis drug Remicade seen as a home run. After years o pharmaceutical side, Weisman is charged not only with identifying new markets for J&J to go after in de but also with spotting ways in whic drug and device businesses might c orate to create new products.

Weisman's cross-functional app ment—a device guy with a pharma p underscores a subtle cultural shift. J& long cultivated a decentralized orga tion, allowing more than 200 comp

Johnson & Johnson's Medical Device Mill

The health-care giant has had some notable hits—and misses—in new-product developme

HIT CYPHER DRUG-COATED

LESSON There is enormous oppor combining insights from the drug b with medical devices.

ACTION J&J has put hotshot scien Weisman in a new position to enco collaboration between different bu units and to help spot emerging m J&J is creating venture-capital-like internally to foster more breakthro

erate almost as autonomous busi-
s. As useful as that is to a prolific ac-
, it may not be the ideal structure for
ng new markets. And while J&J
gers have spoken often about the po-
l offered by combining devices and
in one product, the company's de-
alization can also create barriers to
sort of synergy. Asking managers
nly to change the basic way they op-
and collaborate "to some extent is
ercultural," says Michael L. Tush-
a professor of business administra-
t Harvard Business School.

KETFUL OF MONEY"

OF WEISMAN'S new responsibility
coax that process along. He's
ed with helping to spot opportuni-
what he calls "white spaces," mar-
hat any one of J&J's existing busi-
nits might miss. He will also try to
cooperation among various J&J
as the worlds of devices, drugs, and
ostics converge. J&J has some no-
successes there, the most obvious
its $2.6 billion drug-coated Cypher
As more of those openings arise,
nan will be central to getting the
rate groups working together.

Some notable failures make it clear why the innovation rethink is critical. J&J's Charite artificial spinal disk was a flop, as a lack of long-term safety data caused Medicare to resist covering it. Now, J&J is emphasizing projects that produce more cost-effective solutions to healthcare problems, with more input from end users. For example, the Ethicon-Endo unit that is designing the new surgical clip grew out of discussions with physicians about the need to find ways to do less-invasive surgeries. In 2001 the business carved out a new, skunk-works-like unit made up not only of scientists and engineers but also of marketing and regulatory experts who understand what payers will want. The group moved into its own facility five miles down the road from the Ethicon-Endo business, and it was given what Nick Valeriani, J&J's worldwide chairman of cardiovascular devices and diagnostics, calls a "bucketful of money" to create new surgical tools.

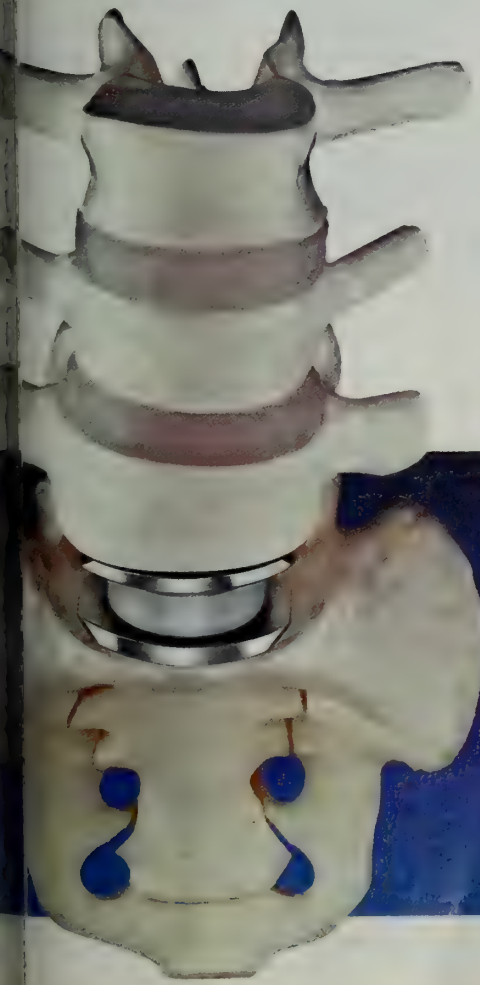
J&J is trying to spark the creation of more of those startups. Two years ago the company began encouraging managers with ideas for cutting-edge new businesses to shop for funding within the company. Teams with a hot idea create a business plan and try to win financing from the company's big venture-capital arm, known as Johnson & Johnson Development Corp., and from one or more of J&J's existing businesses. JJDC has seeded outside startups for years, often taking stakes in companies J&J would later buy outright. Now the idea is to put some of that VC money to work within the company itself. Already, Weisman claims, the effort has yielded four new projects, including one researching adult stem cells.

J&J's big VC arm is now taking pitches from within the company

WEISMAN Identifying new markets is just part of his job

While Wall Street is clearly worried about a slowdown in the device business, J&J executives argue the company has not stumbled. Weisman says the rethinking of J&J's new-product development reflects the shift in the world of medical devices to even more complex products, rather than evidence of any slipup on J&J's part. "I was not brought in to fix something that was broken," Weisman insists. It's true that J&J's R&D operation, with about 15,000 people worldwide, has enjoyed its fair share of breakthroughs. And J&J keeps that R&D machine well greased, having spent $6.3 billion on it last year.

But for a company with a $176 billion market cap, it's going to be tough to find new ventures that will move the needle. Shifting away from the traditional R&D approach toward a more integrated, cross-disciplinary approach to innovation is a start. J&J, one of the bluest of the blue chips, needs something to happen fairly soon to recharge growth and rejuvenate its sagging share price. J&J's problems are significant, but Weisman's business philosophy is pretty simple. "If it works," he says, "we'll keep doing it."



MISS CHARITE ARTIFICIAL SPINAL DISK

LESSON The product has flopped because a number of payers, including Medicare, are resistant to covering the cost, in part due to a lack of long-term data.

ACTION J&J is seeking greater input from physicians, insurers, and others as it develops new devices to understand what advances doctors will embrace and how to increase the odds of widespread reimbursement.

Data: *BusinessWeek*

BusinessWeek online For an in-depth look at J&J's ongoing battles in the stent market, go to www.businessweek.com/extras

Giving Fast Food a Run for Its Money

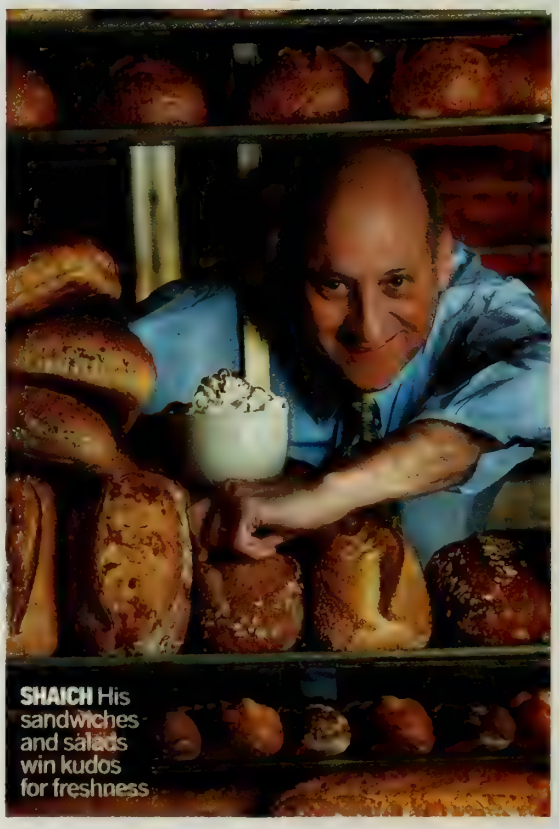
Panera Bread's fans don't mind paying a premium for its healthy alternatives

BY MICHAEL ARNDT

RONALD M. SHAICH, CEO of Panera Bread Co., has spent most of his career trying to upgrade the concept of quick-serve food. Back in the 1980s, fast-food chains had turned into what Shaich now refers to with disdain as "self-serve gasoline stations for the body." So shortly after he earned his MBA from Harvard Business School in 1978, he took a bet that consumers would embrace healthy, premium-priced sandwiches. First he scored big by building up bakery Au Bon Pain into a chain with 265 locations in eight countries. Then, in 1993, he acquired Panera and began preaching its virtues as he opened branches across the country. "It's food you crave, food you trust," says Shaich, between bites of the new Asian sesame chicken salad at the chain's flagship restaurant in Chicago's Loop. "People sense it."

HOT GROWTH COMPANIES

Actually, people are gobbling it up. In 2005, Panera ranked 37th on *BusinessWeek*'s Hot Growth ranking of small companies. Over the past five years, the chain's net income has surged at an average annual rate of 50%, while sales have risen at a 33% rate. Panera earned $81.1 million in profits in 2005, on sales of $640.3 million. Add in results from franchised units, and sales rose to $2 billion. In the meantime its share price, adjusted for a stock split, has more than quintupled, to $73.56.



SHAICH His sandwiches and salads win kudos for freshness

Panera attracts its crowds by focusing on freshness. Breads and pastries are baked at each site from dough that contains no unhealthy trans fats. Shaich revitalizes Panera's menu every two months with a new sandwich or salad. In 2004 it began offering chicken sandwiches m from birds that are 100% free of h mones and antibiotics. To cover the creased cost, it had to hike sandw prices by 7%, to $4.99-plus. But the m ly suburban women who frequent chain didn't balk. The average Panera tron spends $8.51 on lunch, vs. an ind try average of $4.55. Same-store s jumped 7.4% in 2005 and are up a fur 8.9% this year. Panera has troun many fast-food competitor average sales per store (tal

Panera's high prices he offer its patrons food, ar ence, and service that are a above the rest. Unlike r other quick-serve chains, Richmond Heights (I company serves its food hot drinks in sturdy cl with stainless-steel uten Chairs and tabletops wood, and the floors are peted. Employees who pu at least 20 hours a week health insurance, a 40 savings plan, and a discou they buy company stock. S benefits help keep an turnover at 60%, comp with the industry averag 190%. And customers ap satisfied, too. In surveys c in each of the past four y by Sandelman & Assoc Inc., a restaurant consult in San Clemente, Calif., era has ranked first or se as the favorite fast-food cl This year, it also won top ors for quality, cleanli and order accuracy—the three top sons why people pick a restau Sandelman says.

To keep up the momentum, Sh knows he has to reach beyond the l bunch. Panera has recently added b fast soufflés to its menu, and it offers wireless Internet access to draw tomers in the afternoon. Now, Shai targeting the dinner crowd by testi flat-bread pizza and drive-through l Panera is opening 150 stores a year expects to reach 1,000 by the fall. Alr it has just over 1% of the $180 billion fast-food market, estimates Bryan C liott, a restaurant analyst at Rayn

Rolling in the Dough

With an average check of $8.51 per customer, Panera Bread is trouncing its fast-food rivals

EACH STORE'S ANNUAL SALES IN MILLIONS*

Panera Bread	McDonald's	Denny's	Boston Market	Dunkin' Don
$1.85	$1.79	$1.42	$1.10	$0.79

Data: Nation's Restaur

*Average 2004 figures per store based on a sampling of the 100 biggest U.S. chains. Restaurants with waitstaffs

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on Dun & Bradstreet, Inc. listed companies with employee number information. Small and midsize companies are defined as those having between 1 and 2,500 employees. Includes customers of mySAP™ All-in-One and SAP® Business One systems sold through resellers.

James & Associates Inc. in Atlanta. Elliott figures the chain's market share should reach 4% in a decade. "There's a lot of room left," he notes.

Panera's expansion—and Shaich's eye for spotting trends early—has helped the chain withstand lean times, too. In 2003, Americans went on a low-carbohydrate kick. With "bread" in its name, Panera suddenly landed on the do-not-eat list of many Atkins Diet followers. So Shaich acted fast to boost the salad lineup and began promoting Panera's low-carb, whole-grain breads. The same-store sales growth rate skidded to 0.2% but then rebounded in 2004.

DYNAMIC DUO?

SHAICH, 52, came across Panera when it was a 19-store bakery/café called Saint Louis Bread Co. The entrepreneur was ready to explore a new opportunity and liked that Saint Louis Bread's homey atmosphere and fresh-baked treats played well in suburban settings. Within months, he had paid $24 million for the company, which he renamed Panera Bread. Shaich at first viewed it as complementary to Au Bon Pain.

And for a while, both operations seemed to go well together. But Shaich came to fear that Au Bon Pain's growth prospects would be limited by its reliance on competitive lunchtime traffic in large city centers. By 1998 he concluded that Au Bon Pain had peaked. So Shaich, who still works in Au Bon Pain's original market of suburban Boston, sold it for $73 million to a private-equity group—a smart move, since expansion stalled after that point.

These days, everything seems to be going Shaich's way. The Crispani, Panera's new pizza, could be expanded nationally later this year, which would add to dinner sales. And Shaich says the chain will open in Canada within 18 months. Meanwhile, results from Panera's new urban locations such as downtown Chicago indicate that, unlike Au Bon Pain, the concept could thrive in both the 'burbs and big cities.

High marks from customers such as Cynthia Wood are projected to push Panera's revenues to $1 billion in 2007. "The prices are a little more expensive than fast food, but it's well worth it," says Wood, a graphic design teacher who refuses to take her young daughters to McDonald's or other fast-food places. Is Panera near peaking? Shaich doesn't think so. He predicts that the chain ultimately could have 5,000 restaurants. ■

Mission: Precarious

Will Paramount's boss stay in the picture? A big fat hit movie wouldn't hurt

BY RONALD GROVER

AS ONE OF HOLLYwood's savviest talent managers, Brad Grey has seen his share of power brawls. But Grey's short tenure as CEO of Paramount Pictures has been brutal even by Hollywood's barracuda standards. Within weeks of his arrival last year, the 48-year-old Grey was under attack by the industry's rumor mill for hiring Gail Berman, Fox TV's top executive, as his second-in-command. The phone lines began lighting up in his newly decorated suite at the stately Paramount studios with agents complaining that Berman was abrasive and feuded with her top assistants on which pictures to choose—both n in a world where turmoil inside a drives hot projects away to rivals. time, agents say, Grey was speed-d his way through town, soothing fe even as the studio denied any rifts rumors were ridiculous and untrue ple of months ago and remain so says a Paramount spokeswoman.

BUDGET BATTLE

EVER SINCE, Paramount and Grey, ducer of the HBO show *The Soprano* seen more drama than Tony and hi Jersey henchmen. A tense negotiati tween Grey and superstar Tom over the budget of *Mission: Impossi* threatened to shut down the fra flick before Cruise and directo Abrams agreed to cut $50 million the $200 million original. Tc wagged even more in December w initially appeared that Paramour overpaid for DreamWorks SKG's l tion studio, which produced such *Saving Private Ryan* and *Gladia* shelling out $1.5 billion.

The latest woe is that Grey is lin the widening investigation of a priv to the stars, Anthony Pellicano, w been indicted for wiretapping suc

The Good, The **Brad,** And the Ugly

Former talent manager Brad Grey's short reign as head of Paramount Pictures has been one tumultuous ride. Here are a few highlights:

JAN. 2005 Grey named chairman of Paramount to take over on Mar. 1.

MAR. Top Fox TV executive Gail Berman joins as senior film executive. Within months, rumors circulate that Berman is under pressure from Grey for slow start.

APR. Paramount signs deal to distribute films made by Marvel after Universal refuses to make the deal.

JUN. Hardball negotiations by Grey pay off when budget for Tom Cruise film *Mission: Impossible III* is cut; fil into production.

DEC. Paramount buys Dream SKG's live-action unit, paying $ Six weeks later 125 Paramount are pink-slipped, with jobs fille DreamWorks execs. The buzz is could be in trouble after Univer Stacey Snider is hired to run Dr

MAR. 2006 Speculation inter Grey is under pressure. News re

Data: Viacom Inc.; *Variety*; *BusinessWeek*

sonalities as Sylvester Stallone, Garry Shandling, and the wife of billionaire Kirk Kerkorian. Grey has steadfastly denied any knowledge of Pellicano's activities. Sources say that he has testified twice before a grand jury and has been assured he is not under investigation.

Still, the timing couldn't be worse as Grey rushes to turn around Paramount. The home of such hits as the *Godfather* movies, *Saturday Night Fever*, and *Forrest Gump* has slumped in recent years as tightfisted managers have scared off the best projects. Now the strife at Paramount is making it even harder for parent Viacom Inc. to pitch a turnaround story to investors. Last year earnings before interest and taxes at the studio fell to $178.8 million, from $257.3 million in 2002, according to Morgan Stanley.

The pressure on Grey to deliver hits is intense. *Mission: Impossible III*, scheduled for a May 5 release, is a pretty good bet. And prospects are bright for the upcoming Jack Black comedy *Nacho Libre* and Oliver Stone's September 11 film *World Trade Center*. Says DreamWorks co-founder and director Steven Spielberg: "I don't get it. Maybe Brad is just the new kid on the block and folks want to make him show he can run a studio. When *Mission Impossible* [opens] and is a huge hit, this will all evaporate."

But it was Spielberg who, unintentionally, helped fuel more speculation. The famed director pressed Grey and Viacom CEO Tom Freston to lure Universal studio chief Stacey Snider to run DreamWorks for Paramount. That move was seen by some as a backstop should Berman, or Grey, be forced to leave. Spielberg and Freston deny that's the case.

The barrage of negative news aside, Grey has taken bold action, pushing out some top Paramount executives and hiring more aggressive DreamWorks executives. The dismissals weren't always pleasant: Paramount President Donald De Line heard during a business trip to Europe that Grey was courting Berman and quit shortly thereafter. As for the firings, Freston told *Variety* that changing people is never nice work. But he conceded: "We could have handled it better."

"I BELIEVE IN BRAD"

STILL, GREY'S BIGGEST problem may not be his present performance but his past dealings. He has come under increased scrutiny following two *New York Times* pieces that describe his acrimonious 1998 lawsuit against former client Shandling, in which Pellicano is alleged to have wiretapped the comedian and his ex-girlfriend after being hired by Grey's lawyer, Bert Fields, who has denied knowing of the wiretaps. A Grey spokeswoman says he did not know that Pellicano was conducting wiretaps. In another case, *Scary Movie* executive producer Bo Zenga sued Fields, Grey, and Pellicano on Mar. 22 alleging that Pellicano wiretapped Zenga's conversation during an earlier lawsuit filed by Zenga against Grey. That suit was dismissed. Freston says Grey and his lawyer discussed all of this with him before he was hired. "I believe in Brad," says Freston, "and I believe he's telling me the truth."

Entertainment veteran Grey no doubt knows how quickly the knives come out when an executive is perceived as in trouble. "If you have money to buy projects and market films, folks will come running," says former Columbia marketing chief Peter Sealey, a Stanford University business professor. "But if things get worse at Paramount, that will change in a hurry." Clearly, scandal and palace intrigue are best left for the big screen. ■

BusinessWeek online For an interview with director and DreamWorks co-founder Steven Spielberg, go to businessweek.com/extras

indicate his lawyer allegedly hired indicted private eye Anthony Pellicano to wiretap witnesses testifying as part of a lawsuit Grey filed against former client Garry Shandling. Grey denies knowledge of the wiretapping.

MAY 5 *Mission: Impossible III*, the first big film under Grey's reign, set to open.

Blue Chip

How long will the stocks of America's largest companies remain weaklings on Wall Street?

BY ROBEN FARZAD

JUST A FEW YEARS AGO, U.S. BLUE CHIP STOCKS were the most respected asset class in the world. No longer. In May, the $22 billion Fidelity Blue Chip Growth fund, which holds shares of giant U.S. companies such as Microsoft, Johnson & Johnson, and Wal-Mart Stores, will make a surprising request. It will ask shareholders to approve a switch in its benchmark from the Standard & Poor's 500-stock index, a traditional blue-chip barometer, to the Russell 1000 Growth Index, a broader gauge that includes many smaller companies. "The move," says fund manager John McDowell, "reflects the investment style of the fund through thick and thin." Meanwhile, another Fidelity fund, $50 billion Magellan, recently dumped blue chips Pfizer, Intel, and Procter & Gamble and boosted its foreign holdings to 25%, up from 4% just a few months ago.

These are confusing times for the shareholders of America's biggest corporations. General Electric Co. has boosted its earnings by 22% since Chief Executive Jeffrey R. Immelt took the reins on Sept. 7, 2001. But GE's once vaunted stock price has languished during his tenure (page 72). Home Depot Inc., the second-biggest U.S. retailer, has more than doubled its profits since 2001, a feat rewarded with a measly 1.5% bump in its stock price. Intel Corp.'s prize for boosting its earnings by 8% in five years? A 30% plunge in its shares.

A similar malaise afflicts Walt Disney, Microsoft, Pfizer, Wal-Mart, and others across many sectors and industries. What exasperates the leaders of these corporations is that it seems there's little they can do about it. They're delivering the earnings growth, but investors aren't responding. At work are forces largely beyond their control.

Boiling Down to Zilch

WELCOME TO THE BLUE CHIP BLUES. The S&P 500 is near a five-year high. But don't celebrate: It has returned just 4.3% annually during that span, far less than its long-term average of 10%. The S&P 100-stock index—the bluest of the blue chips, with $6.5 trillion in market capitalization and a huge share

Blues

of U.S. corporate profits—has returned just 2.03% annually to investors during that span, chiefly from dividends. Without dividends, it's just 0.94% overall, or 0.19% annually. In any event, after taxes and inflation, that pretty much boils down to zilch. Things have gotten so bad that ISI Group strategist Jason R. Trennert has said blue chips could be "the cheapest asset class in the developed world."

There's no law that says stock prices must track corporate earnings perfectly. But the degree of the disconnect and its long duration (chart, page 68) pose serious questions for CEOs, managers, and shareholders alike. Is this a temporary phenomenon or a permanent structural change? Should America's investor class—the doctors and nurses, couples and singles, clerks and judges—continue to hold these stocks as dearly as they did a few years ago? What would it take to get big U.S. stocks moving again?

Just about everything is crushing blue chips: real estate, commodities, precious metals, international stocks, and smaller U.S. stocks. And investors haven't had to be geniuses to take part in those gains. They've merely had to dust

ILLUSTRATIONS BY CHRISTOPH NIEMANN

off some old ideas. Basic finance theory says that investors can get the best balance of risk and reward by owning pieces of as many of the world's asset classes as they can, from stocks to gold, alpacas to saffron. For years, the S&P 500-stock index of the biggest U.S. companies was the best approximation of that ideal available to investors—and they flocked to it.

But in the past decade, the world's financial markets have changed in unexpected ways. The proliferation of hedge funds, those lightly regulated pools of capital that cater to wealthy investors, has allowed pension fund managers and other institutional investors to venture beyond U.S. shores and seek high returns wherever they present themselves. And the explosion of exchange-traded funds, or mutual funds that trade like stocks, has opened up the world to individual investors in ways that were never before possible. China, Mexico, and South Africa are now just a mouse click away. A decade ago, they were available chiefly through clunky, high-fee mutual funds, if at all.

With more choices, investors are diversifying their portfolios as textbooks say they should. Emerging-market shares, small U.S. stocks, gold, and even commodities are taking up sizable chunks.

Only Game in Town

SOME MARKET STRATEGISTS think this global rebalancing act could be a 10- or 20-year process. But skeptics point out that an overseas financial crisis could erupt at any time and send investors fleeing to the relative safety of the U.S. markets—not unlike what happened during the 1997 and 1998 Asian and Russian sell-offs.

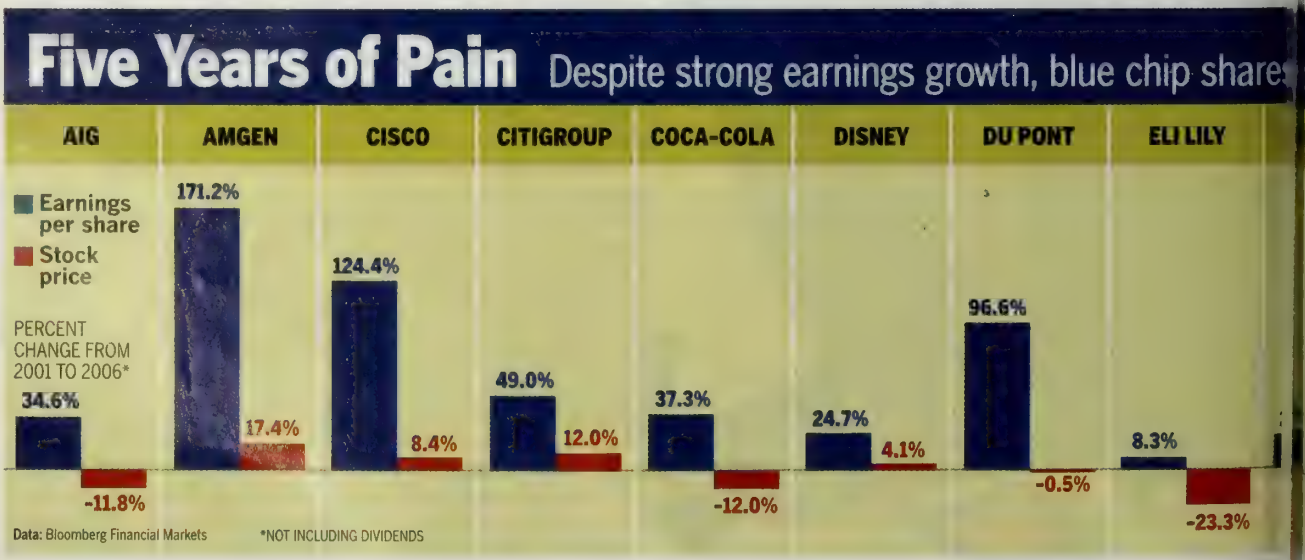
Who's right? Before we can sort out the possibilities, we must understand how the blue chips got so popular in the first place.

The biggest U.S. stocks returned an average of 16% a year during the 1982-2000 bull market, gains that far outpaced the underlying corporate profit growth. In 1981 the average price-earnings ratio for these stocks was around 8. By 2000, at the peak of the tech bubble that sent many stocks to all-time highs, it had swelled to 35. Even a conglomerate such as GE sported a ratio nearly double its current 18. Blue chips "are coming off the biggest p-e expansion in history," says James P. O'Shaughnessy, who oversees more than $6.5 billion at Bear Stearns Asset Management Inc. "In 2000 it was as if there was notl else worth investing in."

Nothing indeed. The bull market resulted from a deart alternative opportunities. Long-term interest rates throughout the period, making bond yields less attracti investors. Prices of oil, other commodities, and precious als fell, too. Two housing busts soured investors on real e by the mid-1990s. Stocks were the only game in town. Th e ratios of companies with growing but stable earn soared, with blue chips enjoying unprecedented popular

Then the profit growth stopped—and with it, blue chip premacy. According to Goldman, Sachs & Co., reported d ings per share of the companies in the S&P 500 fell from $. 2000 to $17.50 by 2002. The largest 100 stocks lost 53%, to trough. Assuming an 8% average annual return, it woul take Cisco Systems Inc. 17 years to hit its 2000 level; Micro 10 years; GE, 8; and Disney, 6.

Smaller stocks have fared much better, for two reasons one thing, their valuations hadn't run up so much in the place. And second, smaller companies are nimbler than ones, and can adapt to changing economic conditions faste blue chip profits cratered in 2002, the earnings of the S&P stock index of small capitalization companies rocketed



5% and 28% the following two years. Investors sought e relative value of small and midsize companies, which eturned an average of 15% and 13% a year, respectively, March, 2001. Small caps once were considered much than big ones. The big-company earnings crash showed en the celebrated blue chips are risky, too.

question is, which period was the aberration: 1982-2000 1-06? History seems to argue for the former. According to on Associates, small caps have returned 11.7% annually 926, vs. large caps' 9.8%.

b Stein, chairman of the il of Economic Advisers President Nixon, once d, "if something cannot forever, it will stop."

ge funds exacerbated the o small stocks. In 1982 vere minor players. But ok off in the late '90s and lly during this decade. superior information-ing allows them to spot opportunities in small nies that aren't widely d. The ability of so-called t hedge funds to trans-mall companies by taking sitions and agitating for has been another lure.

s most important, hedge fund traders are ollowers, traveling in packs into and out t classes. Right now the trend favors small "If you were to stick a gun to my head," ear Stearns' O'Shaughnessy, "I'd say small ill keep beating for 20 years."

n't only small caps that are dominating. hips are getting crushed by just about ning overseas. South Korea was up 54% ar; Latin America, 55%; and Saudi Ara-8%. Russia and a resurgent Japan re- 87% and 42%, respectively. In the past ars, the S&P Citigroup Emerging Market has returned about 17% a year, slightly better than the annual returns U.S. blue chips posted from 1982 to 2000. Could emerging markets pull off a similar 18-year run?

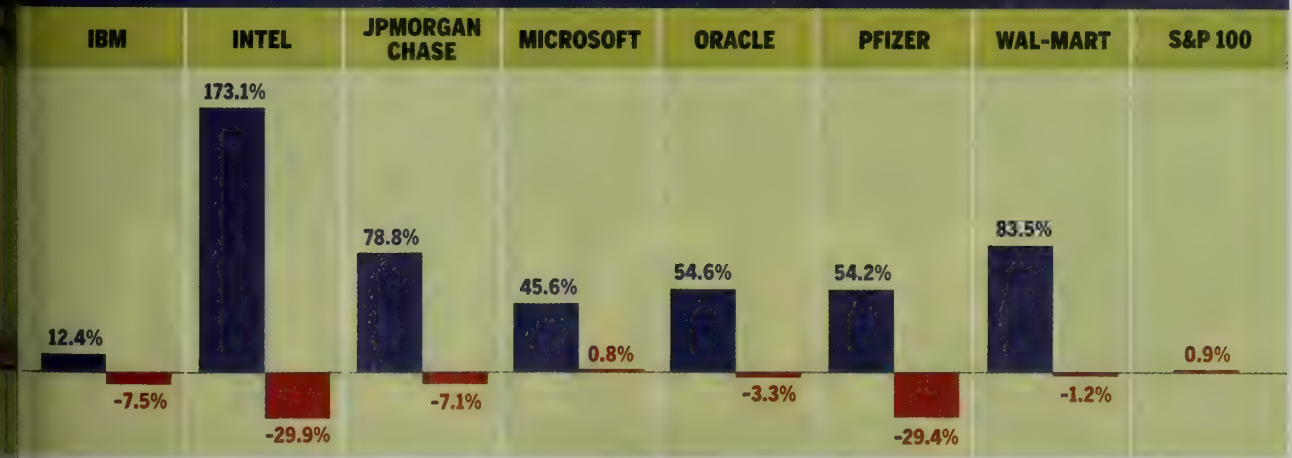
Time was, investors looking for exposure to international and emerging markets would buy shares of a huge U.S. multinational, which supposedly offered transparency and sound governance and none of the crony capitalism found in emerging markets. Then the corporate scandals hit, and big U.S. companies were seen in a different light.

Nowadays, foreign pure plays are getting the benefit of the

Too big for their britches?

Between 1981 and 2000, blue chips' average p-e ratios soared up from 8 to 35 as returns hit 16% a year

where since 2001.



doubt over U.S. giants. For example, shares of Brazil's Banco Bradesco, which trade in the U.S. as American depositary receipts, have soared more than 370% since 2001. Citigroup's shares have gained only 12%, despite the bank's presence not only in Brazil but also China, India, Korea, Mexico, the Philippines, Poland, Russia, and almost 100 other countries. In all, Citigroup derived 41% of its 2005 net income from foreign markets. Yet investors clearly favor the Brazilian pure play.

It's difficult to argue with the growth these nations are posting. According to statistics from the International Monetary Fund, Brazil, China, India, and Russia drove 30% of the overall growth in global demand in 2005, more than double the figure five years earlier.

And so the hunger for international stocks is huge. Since 2003, net flows to international-stock mutual funds have more than tripled, to $150 billion, while flows into U.S. funds have plunged from $154 billion to $64 billion. In January, foreign equity funds' inflows almost doubled those of December.

The explosion of lower-cost exchange-traded funds (ETFs) has only hastened the advance, making it even easier for ordinary investors to jump into and out of emerging markets. Barclays Global Investors offers 37 international and global ETFs holding $72 billion in assets, up from 24 and $2 billion in January, 2001.

Some argue that emerging markets have emerged for good. "The structural story has changed," says Thomas Melendez, associate portfolio manager at MFS Emerging Markets Equity fund, which has returned a erage of 38% annually for the past three years. Emerging kets, he says, will keep growing, diversifying, and cleanin their fiscal houses.

Consider the emergence of red chips, the biggest and companies in China. They don't have the stability of their V ern counterparts, and they carry the risk of major governu intervention. But over the next several years, red chips sh turn bluer. Demand for the initial public offering later this of Industrial & Commercial Bank of China, one of Ch largest financial institutions, is expected to be strong. Alr Goldman Sachs has ponied up $2.58 billion for a 7% s ahead of a potentially $12 billion IPO that's on track to be of the biggest ever.

Yet despite the long rally, emerging-markets panies still trade below their historical averages b on p-e and price-cash flow ratios. "The [emer markets] story has legs for the next 10 years," Melendez. In fact, legendary valu vestor Warren Buffett, who ma fortune with big investmen blue chips such as Coca-Col and Gillette, recently disc that he had made big be four major stock ind three of which outside the U.S.

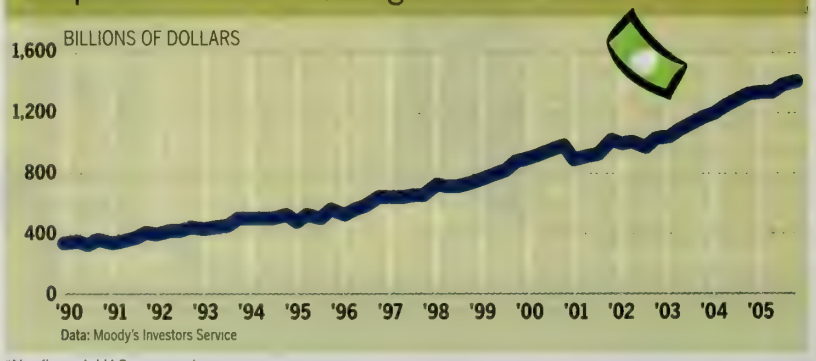
Whether or no share that optin it's clear that big stocks face more compe for investor d than ever b With nearly every else working, should investors b with blue chips?

Predicting the turning points for kets has proved ilous for investors demics, and bus publications alike asset classes mo discernible cycles ing and falling

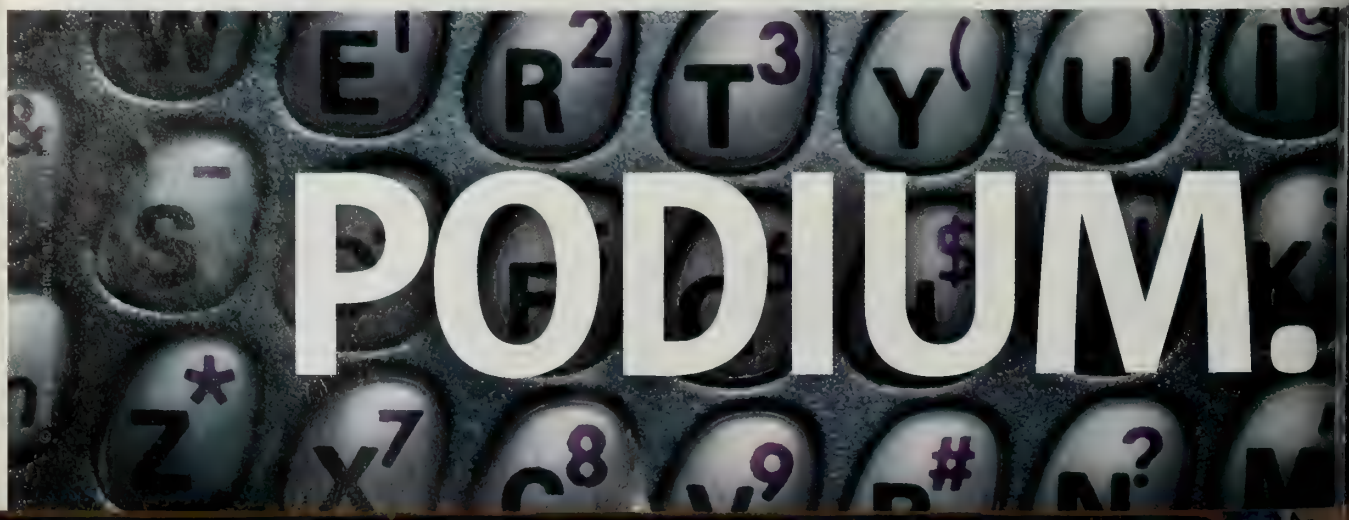
Untapped shareholder value could mean: "Give the money back—or else"

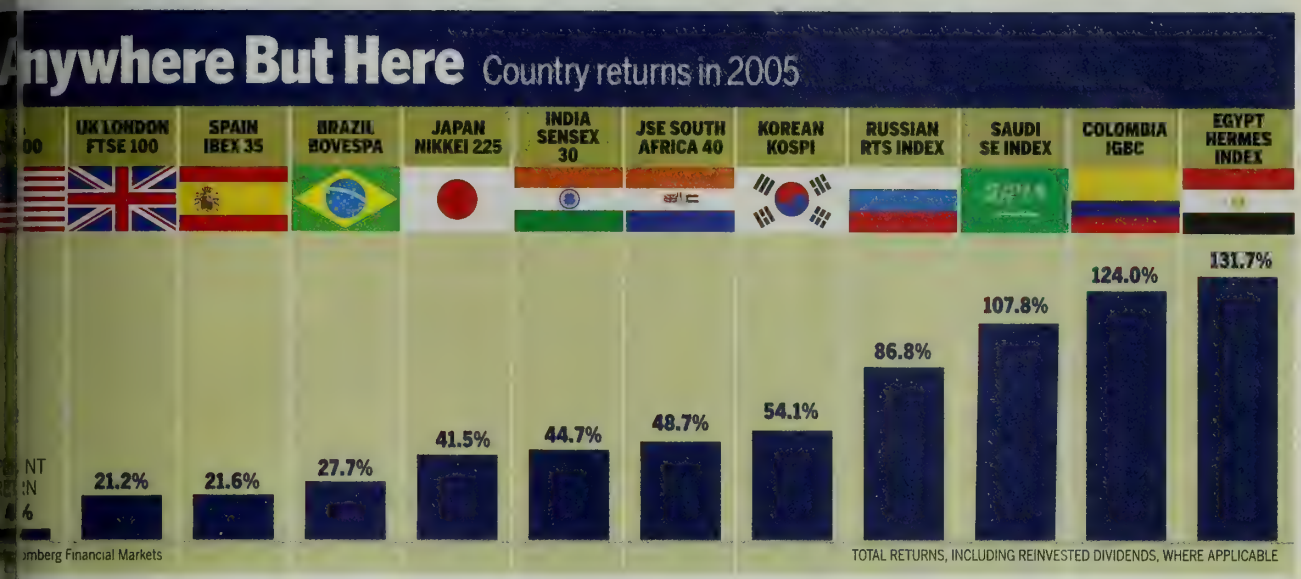
Cash, Cash, Everywhere

Corporate America* is sitting on record amounts



*Nonfinancial U.S. companies





periods of time. Commodities, for instance, ruled the 70s, slumped for two decades, and then resurged recently. Strategists citing the cyclical argument have been predicting a big comeback for 18 months. It hasn't happened yet. Their gripe: 'We listened to blue chip bulls last year, and it did work,'" says Tobias Levkovich, chief U.S. equity strategist at Citigroup. "'[The bulls are] saying the same thing this year, and it's not working.'" The degree to which blue chips have fallen out of favor is remarkable. "When we buy a large cap, we hear: 'Can you buy that dog? It has done nothing for five years,'" Bruton Muhlenkamp, manager of the $3.2 billion Muhlenkamp Fund, which has big positions in several blue chips.

But betting against fund flows, prevailing sentiment, and routines has made contrarian investors rich over the years. "Time to make money," said Lord Rothschild, "is when there's blood on the streets." Big stocks are clearly wounded. "It really hurts to say this again," wrote ISI's Trennert in a Feb. 27 research note to clients, "but we believe large caps are due."

Kitty

ALL OF THE SIGNS that blue chips were overvalued in the 90s are showing up in small caps now. The Russell 2000 index sports an estimated p-e of 25, a 10-point premium to the S&P 500's 15. "What ultimately wins in financial markets is valuation," says Trennert.

If valuation is king, cash is its queen. According to Moody's Investors Service, U.S. nonfinancial companies now hold a record $1.5 trillion of cash—double the kitty of just seven years ago, with blue chips sitting on the most. Sooner or later, activist hedge funds will come a-calling. "The real [opportunity] is now untapped shareholder value," says Trennert. "As in: 'Give the money back—or else.'" Attacks on a few big companies might send their stocks up. And other big-company CEOs might start spending on share buybacks, dividends, and acquisitions, to nip potential activist challenges in the bud. Dividends, of course, can be a powerful component of total return. DuPont's shares, for example, rose just 0.5% during the past five years. But adding and reinvesting dividends jack up the total return to 18.5%. For Microsoft, the numbers are 0.8% and 15.2%.

Rising interest rates would make those cash hoards all the more enticing. "If bond yields creep up, companies will be pressured to do more with their cash," says Marc Freed, managing director of Lyster Watson & Co., a Manhattan hedge fund-of-funds shop. Investors would no longer tolerate idle cash languishing on balance sheets if it could be put to good use.

At the same time, rising rates would hurt smaller companies, which are more dependent on short-term borrowing. So while blue chips would be spending cash in ways to benefit shareholders, small companies could see their earnings decrease as their financing costs rise. That would change the perception of

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small caps as can't-miss investments, and prompt a shift back to blue chips—the long-awaited flight to quality. Trend-following hedge funds would spot the turn faster than most, pile in, and speed things up even more.

Trennert takes the argument a step further. "The single biggest reason that large caps have lagged is that the economy hasn't slowed," he says. "A slowdown would get people thinking about safe, sustainable earnings growth again."

But what of the international funds and ETFs sucking so many tens of billions away from U.S. blue chips? Levkovich says the trend simply can't last. While the relative valuation of the 25 largest S&P 500 companies, including recent winners ExxonMobil, Hewlett-Packard, and P&G, is near a 20-year low, flows into emerging-market funds as a percentage of all equity flows is twice the previous peak. The last time he saw flows so disparate was during the last call for tech and growth stocks in 2000. "You can see

One big reason large cap have lagged is that the economy has slowed. But if people get wor they will want t safety of U.S. equities

COMPENSATION

GE: When Execs Outperform the Stock

When veteran recruiter Peter D. Crist tried to woo a hotshot from General Electric Co. about 18 months ago, the GE executive pressed hard about the potential upside of the stock options he would be leaving behind. Earnings were looking up. GE had expanded into cutting-edge areas such as wind power and bioscience. Innovation was the mantra and people were pumped, with some even talking about a share price that would almost double again, to 60.

With that kind of payoff on the horizon, there was little incentive for him to leave. But when Crist recently resumed discussions with the exec, his optimism about GE shares had faded. If the recruiter's client was willing simply to match the current value of the stock he owned in 2004, he would consider a move. It was the first time Crist had ever seen GE staffers view the stock as a diminished currency. In his view, "If you don't see movement by the end of this year, it could become a real issue in [staff] retention."

Within GE, two beliefs have long been held sacred: talent will be rewarded, and GE stock will make you rich. The first tenet remains as high a priority under Chief Executive Jeffrey R. Immelt as it was under his predecessor, Jack Welch. But the stock hasn't made anyone rich in years and, at less than $35, is worth less than when Immelt took the job in September, 2001.

It's a particularly sore point in a performance-driven culture like GE's. This is the place that famously culls the bottom 10% of staff and vigorously rewards its stars. More than 36,000 employees have participated in GE's stock option program, with the top tier of 180 executives having the potential to receive more than half of their pay in equity. While GE's share price hasn't prompted an exodus, it blunts a potent compensation tool and shows signs of affecting a culture long used to assuming it's the best.

The frustration is palpable in the senior ranks. At GE's annual gathering of its top brass in Boca Raton, Fla., this year, one attendee laughs that stock performance was "the unofficial theme." Then he stops himself: "I guess it's not that funny." Being a victim of broader market trends is one thing. Underperforming the Standard & Poor's 500-stock index by 7% in 2005 is quite another. "It's a bit demoralizing," he says, "especially when you're doing everything else right."

A top-level executive at another company says the prolonged price drought has dampened expectations about what it means to be GE. "A few years ago, [executives] acted like having a stock price in the 30s was a blip," he says. "Now, they're realizing the real blip was what happened in the late 1990s. Some of them may never see those highs [60] for the rest of their career."

So what's a CEO to do? Immelt starts by talking about it—a lot. In many a public forum these days, he's first out of the gate in expressing his disappointment and frustration with the stock price. He raises it at employee town halls. He brings it up at investor meetings, even student groups. "You can tell this really grates on him," says one staffer, who received a grant of options and restricted stock about two years ago.

Efforts to boost growth and creativity are all well and good, but they have to pay off fo the people who own the company. In the recent annual report, entitled "Go Big," Immelt cut to the chase. "The stock is currently trading at one of the lowest earnings multiples in a decade," he wrote. "We have good results and good governance. What will it take to move the stock?" Good question. Immelt clearly feel it's time for the market to wake up. As he pointedly writes: "We earn significantly more income and generate substantially more cash than we did when the stock traded at an all-time high."

To pump up enthusiasm, Immelt has, as he likes to say, put more skin in the game. The GE chief has been steadily beefing up his portfolio—purchasing 30,000 shares in January for almost $1 million and buying another 15,000 shares on Mar. 13 for $502,960. That's in addition to a high-profi move in February to convert his $6 million cash bonus for 2005 into so-called performance share units. Half of the units will convert to stock if cash flow from operations grows an average of 10% or mo over the next two years. The other half will

l, and know it's just a matter of time until it blows up," evkovich. "When people get worried, they will want the of U.S. equities."

a time, they will. But don't expect 2006 to kick off anoth- ear blue chip bull market. One of the byproducts of glob- n has been more efficient capital markets, with swifter ger money flows. That poses a challenge for the millions stors out there still fixated on big U.S. indexes. Stubborn- ing with what used to work is a sure way to fail. "The spoiled us," says Jeffrey M. Mortimer, chief investment of- r equities at Charles Schwab Investment Management. u had to do was show up." Mortimer, who keeps his finger retail pulse by checking in on Schwab branches, says he's ed" by how hard old habits die. "They're looking east for iset," he says.

e reality," says Edward Yardeni of Oak Associates Ltd., we live in a much more competitive world than ever be- Big U.S. stocks will have to duke it out with red chips, aps, gold ETFs, and all the new issues that'll hit the scene ears to come. What's the good news? Increasingly complex financial markets mean more opportunities for investors—and, if they're played right, fewer risks.

Bank on this: The blue chips will see another bull market, and perhaps soon. But with so many choices at investors' fingertips, the easy money may have already been made. Diversification is back. And that's not a bad thing. ■

Beyond Blue Chips

Woulda, Coulda, Shoulda: If you thought U.S. blue chip stocks and bonds alone made for a diversified portfolio, think again.

Tale of the Tape: Citigroup vs. Banco Bradesco. How the banking supermarket stacks up against Brazil's financial giant

The Story Behind the Story: For an interview of Wall Street Editor Roben Farzad by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm

BusinessWeek online

www.businessweek.com/go/extras

ert into shares if returns at least match e of the S&P 500 during the same d. He could get almost 180,000 es—or nothing. "He's willing to take $6 on in pocket and put it on the line," says am J. Conaty, GE's senior vice-president rporate human resources.

en again, this is a man who is likely to d at least 15 more years in the top job. pite the stock ums, his board has behind him every of the way.) For other utives, sitting on a nest egg could be of a problem.

nce can wear thin this being GE, senior le are often seen as or plucking to tive executive ions elsewhere. Even s stock price picks up, as in recent weeks, uestion is whether it ompete with the tial returns offered by . Crist says GE has of 48-year-old guys know they're done." careers won't rocket further at GE, and their opportunities to e real wealth seem to have stalled.

naty acknowledges the importance of ock in overall compensation, but says rimary motivation for GE staffers ins "challenging jobs and a career path rsonal growth." Even amid the tough run, the company has retained 97% of 600 executives—"people we really about and don't want to lose," he notes—and hasn't seen "any crazy spikes in turnover" lower in the ranks. Conaty says GE continues to pay strong salaries and cash bonuses to top performers.

But the company has responded to the realities that its stock might not soar as it did during the tech boom. Stock recipients now get a mix of 60% options and 40% restricted stock—a move that Conaty attributes to lackluster stock market growth. Even in a dud market, nobody emerges completely empty-handed. The company has also doubled, to 550, the number of top executives eligible for "contingent long-term performance awards." That means lucrative bonuses if the company meets specific financial goals over a three-year period that are seen to "contribute to shareholder value." Simply getting tapped for participation in things like the stock-option program is often potent enough to keep people excited, Conaty maintains. "It's a signal from your leader that you're doing well." But everyone wants a payoff, too.

The fact that some analysts have boosted their expectations for GE's share price is some comfort to the troops right now. "It's realistic to expect it to outperform the S&P, as the fundamentals are very strong," says Ann Duignan of Bear Stearns & Co.

Nicole Parent of Credit Suisse Group is also optimistic, and understanding, arguing that "Jeff was handed a portfolio that needed a lot of strategic thought put into it." It's hard to win investor confidence when you're overhauling the portfolio and rivals like United Technologies Corp. and Emerson Electric Co. have posted better returns.

But A.G. Edwards & Sons Inc. analyst Tony Boase perhaps best sums up the ethos of investors still waiting to see GE firing on all cylinders—especially in the industrial businesses that account for about half of earnings. In his mind, 2006 is a critical year for proving that Immelt's rejiggered company can outperform its rivals. Investors will stay skittish, says Boase, "until the big machine really moves again." For Immelt, one key to doing that is convincing his people that the market will finally recognize their efforts.

–By Diane Brady

IMMELT "We have good results....What will it take to move the stock?"

(BOTTOM) PHOTOGRAPH BY RAJESH NIRGUDE/AP/WIDE WORLD

The Profit Picture Could Get Uglier

Analysts' estimates have already been lowered, but numbers may drop further

BY MARA DER HOVANESIAN

FOR ALMOST THREE YEARS, the companies tracked by the Standard & Poor's 500-stock index cranked out record profits, beating forecasts by a mile. Then the fun stopped. Earnings growth of 14.3% in the fourth quarter of 2005 was nothing to complain about—except that it missed Wall Street expectations by more than two percentage points.

Just a fluke? Some prominent pundits think not. As the first-quarter earnings season kicks into gear with Alcoa Inc.'s quarterly announcement on Apr. 10, they say a surprising number of companies will miss by even more than they did when they reported fourth-quarter results in January. "There are going to be more big negatives than there have been in the past, and those will make headlines," says Gordon B. Fowler Jr., chief investment officer of Glenmede Trust Co. in Philadelphia, which manages $14.8 billion.

That's especially worrisome for investors given that first-quarter forecasts have already been ratcheted down since the start of the year (table). Consensus estimates peg earnings growth for the S&P 500 at 11.3% for the three months ended Mar. 31, according to Thomson Financial, down from a projected 12.6% on Jan. 1. Morgan Stanley Chief Economist Richard Berner says by the end of the year the Street will need to lower its growth estimates from 13.3%, to 7.5%, a huge drop. "Analysts should start to pull in their horns," he says, and tighten their estimates to reflect the weakening he sees. If his prediction proves correct, by the second quarter the S&P 500 will break its streak of 12 consecutive quarters of double-digit earnings growth—a feat matched only once since 1950, notes Thomson Financial.

Still Searching

Some on Wall Street say falling earnings estimates aren't low enough

SECTOR OF THE S&P 500	EARNINGS GROWTH JAN. 1 EST.	EARNINGS GROWTH MAR. 31 EST.
Consumer discretionary	15%	7%
Consumer staples	7	3
Energy	44	43
Financial	2	5
Health care	7	3
Industrials	12	13
Materials	0	-4
Technology	20	15
Telecom	20	22
Utilities	10	9
S&P 500	12.6	11.3

Data: Thomson Financial

Not everyone is bearish. "I still think there are relatively robust profits out there," says Richard Yamarone of Argus Research Corp. in New York, citing strong first-quarter economic growth. He calls the bears "Negative Nellies."

April is a critically important month. First-quarter earnings reports give analysts the first glimpse of what the cale year might look like. They'll readjust entire 2006 forecast based on these bers. A series of severe earnings n would take investors by surprise ar most certainly roil the stock m

To be sure, the fourth-quarter ear results roiled nothing; stocks finishe uary higher. But if history is a guid numbers were ominous. Analysts te underestimate earnings growth at th ginning of an economic rebound throughout most of an expansion. Bu in the business cycle they tend to ove mate earnings growth, assuming the times will last longer than they actual The fourth quarter might have bee turning point.

That's especially so given the intere environment. When short-term rate higher than long-term rates, as they during much of the first quarter, the has always been an earnings recess meaning profits actually fall—noted M Lynch & Co.'s North American econ David Rosenberg, to clients in Decem

Some say the likelihood that today long-term rates reflect a foreign ap for Treasuries more than bearishnes American growth prospects means rate earnings might stay in the bla time. But short-term rates are the sue. As they rise, says Berner, so wi rowing costs, denting profits.

For investors, a scenario of overl mistic earnings estimates isn't a one. Says Fowler: "We're in for a c market." ■

BusinessWeek weekend For more on this story, watch *BusinessWeek Weekend*. Check your local listings or go to businessweekweekend.com

We want you to know

Aetna's Information

"By far the richest online selection of the Big Three."

–*BusinessWeek*

In *BusinessWeek* magazine's recent comparison of Web sites and information tools offered by the top three national health insurers, Aetna received the highest marks. According to their article, they "found the richest set of offerings at Aetna's site." And Aetna's online survey to help members evaluate and manage their health was said to be "the most comprehensive." To learn more about how our information can help your employees make better health care decisions, call your broker, Aetna representative, or visit us online at aetna.com.

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200615

NEW BLOOD Bolten, with his boss, could bring in more thoughtful critics

Memos to Josh Bolten

What management gurus would do to get the Bush White House back on track

BY DIANE BRADY

JOSH BOLTEN MAY HAVE managed the nation's budget amid record deficits, but that could start to look like a holiday after a few weeks as George W. Bush's new Chief of Staff. Even many who love Bush's vision concede that the nation's first MBA President has fallen short on execution.

As new product launches go, the President's Social Security plan was a flop. The failed Supreme Court nomination of White House Counsel Harriet Miers provoked protests from the right and bipartisan dismay. Republicans joined Democrats in condemning the attempted sale of key seaports to a Dubai company, a deal that the President apparently didn't know about until it hit the press. Add to that the bungled response to Hurricane Katrina and disarray in Iraq. Bolten, a Beltway-born bachelor workaholic known for his smarts, bowling score, and loyalty, has plenty to keep him busy.

BusinessWeek asked some of the country's leading management thinkers to offer tips that might help Bolten, 51, when he steps into the new job on Apr. 15. They cast aside their political leanings to assess how best to tackle what Justin Menkes, author of the best-selling *Executive Intelligence*, calls "one of the most difficult jobs on the planet." Menkes believes that Bolten can help his beleaguered boss boost his performance by bringing in more outside voices and pushing Bush to pause more before making decisions. "The best leaders ask questions," says Menkes.

So where to start? Leadership guru Noel M. Tichy says Bolten's first step is to frame his job clearly. Some White House Chiefs of Staff act as little r than gatekee or special a tants, while ers morph chief operating officers. Tichy Bolten's role as "proactively contribu to this leader making the best judgi calls possible for the good of the cour Some key areas: helping decide w staff members are in or out and ho handle the inevitable next crisis.

> The new Staff Chief's biggest task is to break through the groupthink

One challenge for Bush is that hi ner circle not only admires him but seems to think like him, says Jeffre Sonnenfeld, senior associate dean a Yale School of Management. "There' much agreement; they can't imagine ure." Time to bring in thoughtful cri

Anne M. Mulcahy considers that o the best moves she made after beco CEO of Xerox Corp. "The reality is once you step across the threshold t corner office, things change," she r adding that it's not enough to tap p who will tell it like it is. Leaders ha "schedule time for this express pur Don't leave it to chance."

DIVERSE OUTER CIRCLE

IF THE INNER CIRCLE isn't up t task, Bolten has to focus on building terrific outer circle, says Wharton pr sor Michael Useem. He argues tha goal is to recruit a broad array of sy thetic authorities who are truly diver philosophy and life experience. "The a sample of those people before the ident as often as possible," says Us The goal: to encourage Bush to con new means of accomplishing his ag

Sure, it's the guy's last term "there's still plenty of time to have impact," says Sydney Finkelstein of mouth's Tuck School. For exampl how a President can shift gears, he p to the scandal-plagued second ter Ronald Reagan, when the White H brought in respected former Se Howard H. Baker Jr. as Chief of Staf to the Kennedy Administration. The Bay of Pigs Invasion w unmitigated disaster many blame on groupt But Kennedy learned son, brought in critics was better prepared f Cuban Missile Crisis i "When things are cha ing, there's a natural te cy to circle the wagons, Finkelstein. A good Ch Staff will welcome out around the campfire.

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Getting Out Of Dodge

Top talent is fleeing the Big Three to escape declining morale and shaky prospects

BY DAVID WELCH

GENEROUS MOTORS IT isn't. Not anymore. Just ask the several hundred General Motors Corp. managers who were fired on Mar. 28. They were each taken aside and given a severance package, told to surrender their keys and badges, and allowed a month to turn in their cars. And while the hundreds of layoffs didn't amount to the "Black Tuesday" many managers expected, GM is just getting started. It plans many more such job cuts this year.

No sir, life in Motown isn't much fun these days. The rank and file of the United Auto Workers may be trembling in their steel-toed boots as GM and Ford Motor Co. gear up to impose tough new contracts and layoffs. But in the design studios, engineering labs, and corporate offices, the companies' white-collar professionals are experiencing the same kind of anxiety, gloom, and resignation as their blue-collar brothers and sisters.

GM Chairman G. Richard Wagoner and Ford Chairman William Clay "Bill" Ford Jr. exhort underlings to get jazzed about turning their companies around. But the troops are finding it hard to stay pumped. Executives get excited about new car projects only to watch them die before they get out of the studio. Middle managers find themselves reporting to a revolving roster of bosses. Pay, benefits, and perks aren't what they were.

And because the companies are erasing layers of management, the opportunities for advancement are dwindling. Many industry professionals believe the tough medicine will help their companies, but the turmoil is enough to wear down even the most determined optimist. "It's bad news after bad news," says a GM engineer. "It's not going to end anytime soon."

RESUMES ARE FLYING

IS IT ANY WONDER that more and more Ford and GM executives are thinking about hitting the road? Headhunters report a steady flow of résumés from top Motown managers. "Not a week goes by without a Detroit executive telling me: 'If you see something outside the industry, I'd love to look at it,'" says Brad Marion, who runs the auto practice at executive search firm Korn/Ferry International.

Detroit's carmakers—even relatively healthy Chrysler Group—are already losing key talent. Ford lost its hybrid chief, Mary Ann Wright, to auto parts maker Collins & Aikman Corp. Levi Strauss & Co. snagged GM's chief financial officer for North America, Mary Boland. Dell Inc. got the auto maker's top quality officer, Annette Clayton. And Chrysler marketing whiz Julie Roehm fled to Wal-Mart Stores Inc. "If people at that level are leaving," says a GM product developer, "how bad are things going to get?"

It's hard to tell how worried Detroit should be. Kathleen S. Barclay, GM's vice-president of human resources, says they have no trouble filling the jobs. She adds that those who stay are undeterred, even energized, by the challenges. The auto makers also say turnover isn't much higher than usual. Still, one Ford executive concedes "if this keeps happening, the talent pool will get pretty shallow."

How things have changed since Detroit's heyday. The Big Three had their pick of the brightest stars. Just five years ago GM and Ford were cherry-picking talent—swiping hot stylists from European carmakers and marketing bigs from the likes of Procter & Gamble Co. and General Electric Co.

Back in the day, Detroit also could afford to pay for it ployees' loyalty: fat bonuses, unio iber bennies, and a virtual guaran lifetime employment. It wasn't un mon for Detroit professionals to around for 40 years. Or to find thei and daughters climbing the ranks behind them. That's Mary Ann Wr story. "Ford took care of our family, Wright, whose father was a Ford neer. "I thought, 'God, I'm suppos work for Ford forever.'"

Wright found huge satisfaction t

On the Exit Ramp

Why some of Detroit's best and brightest are hitting the road

NO FUTURE

GM and Ford are flattening their management ranks. Given their declining share and financial woes, that's a good thing. But it means fewer opportunities for Type As.

SICK CULTURE

Shrinking budgets, soul-destroying bureaucracy, and a revolving lineup of senior managers who lurch from one turnaround strategy to the next are hell on morale.

BETTER GIGS

Auto execs are winding u everywhere from Levi Strauss to Wal-Mart to D companies that are look to expand—not contract some cases, these folks their pay rise.

A/ BOLAND
d b: CFO for GM North America
w ob: CFO for Levi Strauss North America

scape hybrid sport-utility vehicle lab to showroom. And she was d up to roll out a fleet of hybrids by But budget cuts and management meant "we weren't getting any done." Wright also endured con sniping that hybrids were a waste of In September a colleague sent an e essentially asking: Why bother? n after, Wright told Bill Ford she uitting. He asked her to stay, but she damant. "When you're not having Wright says, "it's time to go." She aced in February as Collins & Aik vice-president of sales and pro management. Her new employer is ion of Ford's size and struggling to e from bankruptcy. But there are ensations; including bonus, Wright, ould make more than $600,000, ly double her take at Ford.

JOEL PIASKOWSKI
Old Job: Buick Designer at GM
New Job: Chief Designer for Hyundai North America

For executives overseeing the wholesale downsizing at GM, going to work can be especially draining. As the company's CFO for North America, Mary Boland spent her days scouring financial data, looking for ways to slash costs. That included figuring out which plants to close and dealing with the knowledge that these decisions had real-life consequences for families and communities. "It has been many years of downsizing at GM, but the last couple of years took its toll [on me] physically and mentally," Boland says. "I want to give 110%, but I felt I couldn't keep up the pace."

Yet she found it hard tearing herself away from an industry that had also employed her father for decades as a tool-and-die maker. Before becoming CFO in 2004, Boland, now 48, had worked at the company for a quarter-century. Finally, though, her family nudged her into taking the CFO job at Levi's.

"A PRETTY DEPRESSING PLACE"

WHEN SHE FINALLY took the plunge, Boland says, it was a big weight off her shoulders. Levi Strauss has completed its downsizing, having shifted its manufacturing offshore a few years ago. Now the company is looking for ways to grow rather than shrink.

Like Wright, Boland got a pretty decent package. She wouldn't give numbers, but says she got "a significant raise" to take the same job she had at GM. And every morning she wakes up in the tony San Francisco suburb of Tiburon, where she sips coffee and looks out over San Francisco Bay. Her morning commute takes her across the Golden Gate Bridge, a far cry from her old drive on Detroit's potholed John C. Lodge freeway. Says Boland: "Southeast Michigan is a pretty depressing place to be right now."

Detroit's rivals are only too aware of that, and they are taking advantage of the Motown malaise. The Japanese and Korean transplants are expanding, grabbing market share, and paying good salaries. So it's easy to see why Detroit professionals are going to work for the competition.

One is Joel T. Piaskowski. He's only 38, but he's the guy who designed the Buick Lucerne, one of GM's successful new models. Three years ago, Piaskowski quit GM and went to work for Hyundai Motor Co. in sunny Irvine, Calif. Today he's Hyundai's chief designer for North America, and other young Motown designers have followed in his wake.

GM wasn't in full downsizing mode when Piaskowski made the move. But he found it hard to make an impact. While GM was having trouble funding new car programs, Hyundai was adding models and even contemplating a luxury brand. Piaskowski saw an opportunity to put his stamp on an entire lineup.

Since he left GM, a dozen Big Three product developers have joined Piaskowski at Hyundai. And Cadillac designer Tom Kearns is now chief designer for North America at Hyundai sibling Kia. "I didn't recruit them," says Piaskowski. "They followed the buzz." And what about loyalty to his home town? Piaskowski's dad was a Chrysler designer, after all. "If it wasn't me," he says, "it would have been someone else." That's the last thing Detroit's auto makers need to hear. ■

DETAINED Glovis CEO Lee Ju Eun is escorted by state prosecutors

A Scratch on Hyundai's Paint Job

As a scandal widens, questions about the chairman's sweet deal with an affiliate

BY MOON IHLWAN

ON THE SURFACE, THE arrest of the chief executive of a key affiliate of Hyundai Motor Co. seems to be a classic case of Korean corporate shenanigans. State prosecutors on Mar. 26 raided Hyundai's offices, and have accused Korea's biggest auto maker of using companies controlled by Chairman Chung Mong Koo's family to raise money for illegal political lobbying. Police detained Lee Ju Eun—the CEO of Glovis Co., Hyundai's auto-shipping arm—and grabbed computer hard drives and paper documents. Lee has been charged with creating a $7.2 million slush fund, while Hyundai group executives, including Chung's son, Eui Sun, have been barred from leaving the country.

The raid comes as Hyundai has surged to the front of South Korea's corporate pack. The company, like much of Korea Inc., has buffed up its image in recent years. Its well-designed cars today score near the top of customer satisfaction surveys, and have made a big splash in the U.S. Hyundai's shares, which have nearly quadrupled in the past three years, are a must-have emerging-market play for institutional investors.

The Glovis case, though, highlights something investors might be even more concerned about than the allegations of political corruption: the company's ownership structure. In 2001 the Chungs put up just over $5 million to become the sole shareholders of Glovis. Last December the company was listed on Korea's bourse, and today it is worth $1.6 billion, although its stock price has dropped 11.5% since Lee's arrest. The Chungs now own 60% of the company, a stake valued at nearly $1 billion. They have already received some $180 million in profits, thanks to dividends and the 2004 sale of a 20% stake to Norwegian ship company V Wilhelmsen.

The reason Glovis' met rise? Hyundai and its affiliate Kia Mo Corp. gave Glovis exclusive rights to liver vehicles to customers at home abroad. In its first year of operation, vis posted a net profit of $6.7 millio sales of $203.4 million. By last yea earnings had climbed to $81.9 millio sales of $1.58 billion.

SHAREHOLDER ISSUE

ALTHOUGH THIS SETUP is perfectl gal in Korea, it has shareholder r groups hopping mad. "If a Glovis arrangement were made in the Hyundai board members would been sued, and the profits made by C man Chung and his son would have returned to the company," says Sang Jo, of People's Solidarity for Pa patory Democracy, the pioneer of sh holder activism in Korea. Kim says until Glovis was set up, profits from ping belonged to the auto makers, th by benefiting all their shareholders.

Hyundai defends the arranger Company officials say that by havir arm specializing in logistics, deliveri more efficient and flexible. Hyu spokesman Jake Jang emphasized tha company broke no laws in setting up vis. Hyundai declined to comment o raids, citing the ongoing investigatio to pass a request for comment on t Chung family. A Glovis spokesma clined to comment or to provide a co for Lee's attorney.

Such deals were supposed to thing of the past. In recent years, Ko businesses and the government been pitching global investors o idea that the country takes corp governance seriously there has been pro Hyundai, for exampl filled four of its board seats with ou directors, while its committee now co solely of independe rectors.

But if Chung is to ize his dream of tu Hyundai into one o world's top five auto ers within five year will have to im Hyundai's corporate ernance as much as h its cars.

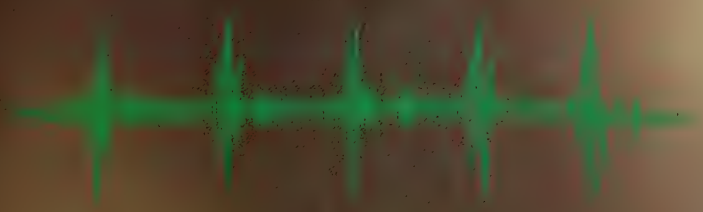
THE STAT

$1.2 BILLION

The Chung family's gain on a $5 million investment in a Hyundai affiliate in 2001

Data: Korea Exchange, Financial Supervisory Commission (Korea)

ination at work



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'The Pit Bull Of Public Relations'

Eric Dezenhall serves clients such as ExxonMobil by going after their foes

BY EAMON JAVERS

WHEN GREENPEACE USA found itself the subject of an Internal Revenue Service audit last year, the environmental group thought it knew whom to blame: Public Interest Watch, a Washington nonprofit heavily funded by Exxon Mobil Corp. PIW had filed an IRS complaint against Greenpeace in 2003, accusing it of abusing its tax-exempt status. Greenpeace assumed ExxonMobil had used PIW to harass a persistent critic.

But the story, first reported last month by *The Wall Street Journal*, was even more complicated. PIW, it turns out, has close ties to Dezenhall Resources, a communications firm known for stealthy assaults on its clients' foes. Founder and CEO Eric Dezenhall, who is also a TV pundit and writer of mystery novels, explained his perspective in a 1999 nonfiction book, *Nail 'Em! Confronting High-Profile Attacks on Celebrities & Businesses*. "Damage control used to be about soft, fuzzy concepts like image," he wrote. "Now it's about survival, and this has made the battle bloodier."

Dezenhall Resources occupies a small niche within the public relations business that includes Sitrick & Co. in Los Angeles and Qorvis Communications in Washington. Kevin McCauley, editor of *O'Dwyer's PR Report*, a trade publication, regards Dezenhall as one of the most effective in his specialty, calling him "the pit bull of public relations."

NO FINGERPRINTS

DEZENHALL FREQUENTLY appears on TV and radio to critique the damage-control skills of the likes of Wal-Mart, Martha Stewart, and even Vice-President Dick Cheney. But it's difficult to identify what he does for his own clients. Dezenhall won't name them, and he doesn't like to leave fingerprints. Interviews with people familiar with his firm reveal a shop that follows the combative credo outlined in *Nail 'Em!* It has been hired by lawyers representing former Enron CEO Jeffrey Skilling and by Mark J. Geragos, the Los Angeles attorney for Michael Jackson and other celebrities. Pharmaceutical giant Eli Lilly & Co. has retained Dezenhall in the past but won't say why. Journalist Bill Moyers, who tangled with Dezenhall's firm over a 2001 documentary about the chemicals industry, says: "I consider them the Mafia of industry."

Dezenhall, 43, grew up in New Jersey and graduated from Dartmouth in 1984. He worked briefly in the communications office of the Reagan White House and then joined a Washington PR firm before starting his own outfit in 1987. (The semi-autobiographical hero of his novels, Jonah Eastman, is an image massager and amateur sleuth who mixes with South Jersey mobsters, journalists, and politicians.) Although active in Re can politics, Dezenhall has profes admirers across the ideological trum, says Chris Lehane, a spokesman for Al Gore. "They have good reputation," Lehane, now a munications consultant in San Fra says of Dezenhall Resources.

Targets of Dezenhall's tactic things differently. "We now know doing the invisible work to underm forts to protect the environment Kert Davies, Greenpeace USA's re

Fighting Fire with Fire

Here are some cases that demonstrate Dezenhall's combative credo:

O'MELVENY & MYERS

Tactics: Retained by this law firm representing former Enron CEO Jeffrey Skilling (right), Dezenhall Resources prepared a strategy to pay newspaper pundits to challenge whistleblower Sherron Watkins**

EXXONMOBIL

Tactics: Arranging for a counter-demonstration to deflect attention from environmental protest*

CHEMICALS INDUSTRY

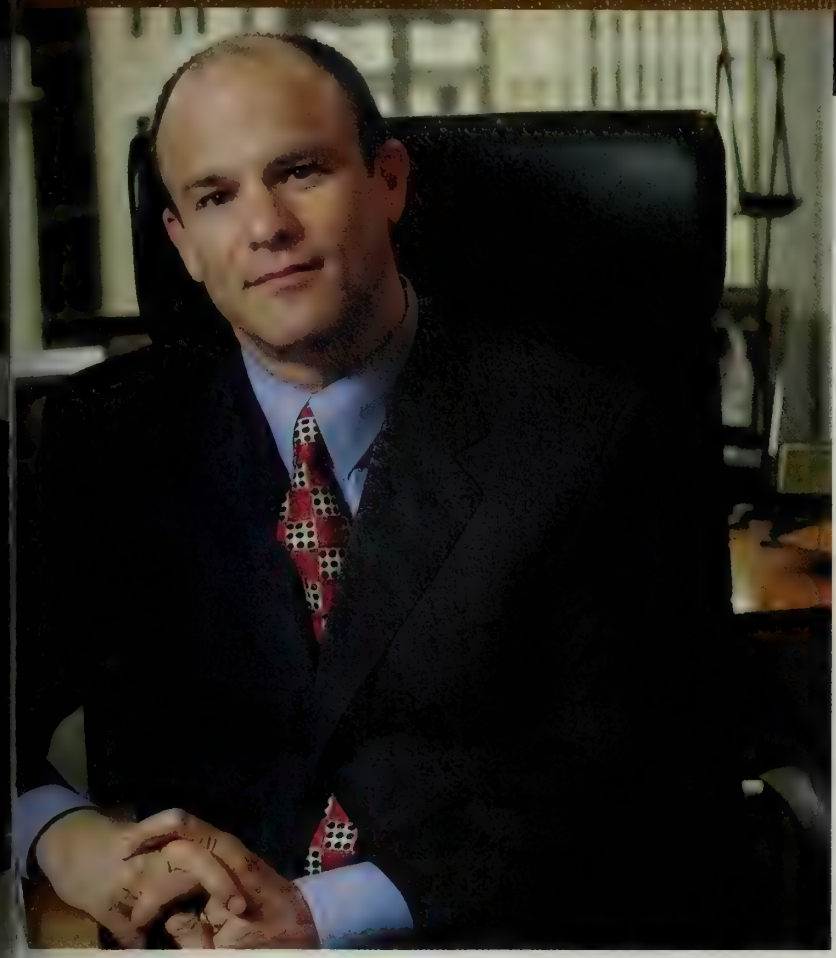
Tactics: Casting doubt on the fairness of a Bill Moyers TV exposé

MOTEL 6

Tactics: Undermining claims by a couple who said they had been spied on in their motel room

*Participants deny being paid by the Dezenhall firm

**O'Melveny partner Daniel Petrocelli says the firm had nothing to do with a proposed anti-W



> "Damage control used to be about soft, fuzzy concepts like image. Now it's about survival"
>
> —*Eric Dezenhall, CEO, Dezenhall Resources*

r. The IRS said last month that the could remain tax-exempt.

enpeace thought its audit problem ted from Public Interest Watch, according to federal tax filings re- $120,000 of its $124,000 in rev- rom ExxonMobil in 2003, the year iled its IRS complaint against peace. But a person familiar with uation says Dezenhall Resources create PIW in 2002 specifically to e IRS to go after Greenpeace. Two 's three founding board members mer Dezenhall employees: James thy and Christopher Meyers. Mc- , who now has his own PR business til last year used space in Dezen- esources' Connecticut Avenue of- eclines to comment on whether the lped launch PIW. Meyers didn't re- to phone messages.

third PIW founder, Michael J. man, says in an e-mail exchange e started the group after sparring onprofits over land-use issues. He respond to e-mail and phone mes- asking about Dezenhall Re- s' role. Eric Dezenhall similarly respond to requests that he ex- ny ties to PIW. ExxonMobil de- to comment, saying through a man: "It's our policy not to dis- r business relationships."

June, 2002, engagement involving ExxonMobil, Dezenhall Resources arranged a pro-Exxon demonstration on Capitol Hill, according to people familiar with the situation. At Dezenhall Resources' behest, the several dozen demonstrators were brought together by the conservative Washington nonprofit Americans for Tax Reform, these people say. Participants waved signs reading "Capitalism Rocks" and "Stop Global Whining." Their aim was to counter an environmental protest at an Exxon station near the Capitol.

FINANCIAL TIES?

DEZENHALL RESOURCES has provided financial backing to Americans for Tax Reform, say people familiar with the communications firm. But ATR says it has no indication that the Dezenhall firm paid for the 2002 demonstration. "The staff here I spoke with said they don't have any recollection of payment for this specific event," says ATR spokesman John Kartch.

In an e-mail answer to questions about the incident, Eric Dezenhall doesn't comment on any ties to ATR but says: "We routinely support think tanks and other experts whose positions are consistent with our clients' views, and will continue to do so unapologetically." He declines to say whether Exxon has been a client.

In the mid-1990s, Motel 6, a unit of the French company Accor, was threatened with potentially embarrassing publicity stemming from claims by a couple that a peephole allowed them to be observed during intimate moments. Dezenhall wrote in his 1999 book that his investigators discovered that the peephole story was bogus and that the accusers had a history as con artists. As a result, a TV newsmagazine segment in the works never aired, Dezenhall wrote. A Motel 6 spokeswoman confirms this account.

Jeffrey Skilling's Los Angeles-based law firm, O'Melveny & Myers, hired Dezenhall in the wake of Enron's collapse in 2001. Internal Dezenhall communications from 2003 show that employees there discussed a plan to pay newspaper opinion writers to publish articles questioning the credibility and motivation of Enron whistleblower Sherron Watkins. It couldn't be determined whether the idea was put into action. O'Melveny partner Daniel Petrocelli, Skilling's lead lawyer in the Enron fraud trial, says that the relationship with Dezenhall has ended. Petrocelli says that if any anti-Watkins campaign took place, Skilling and O'Melveny didn't approve: "That's not something we would ever do."

Without confirming O'Melveny as a client, Dezenhall says: "We aggressively pitch journalists on story ideas, but we do not pay for coverage." ■

SCOOP Do
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instant mes

Silicon Valley Confidential

How did a 21-year-old college dropout become tech's gossip hound?

BY JESSI HEMPEL

UNTIL RECENTLY, NICK Douglas did most of his blogging from a linoleum-floored dorm room at Grove City College, a small Christian campus in rural Pennsylvania. Most mornings, he fired up his ancient Compaq Evo laptop, wedged a scrap of paper into the earphone socket so his headset would work, and keyed snarky, insidery comments on Blogebrity.com, the Web log he wrote together with other bloggers. The site tracked luminaries such as Nick Denton, founder of the burgeoning blog empire Gawker Media.

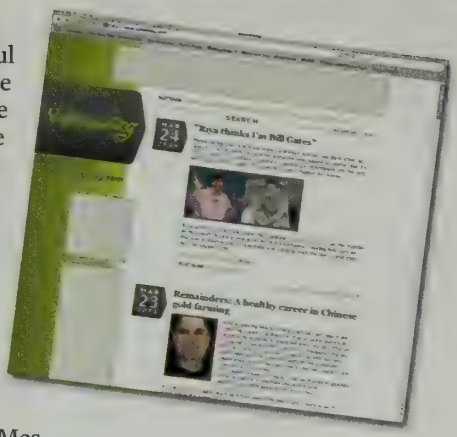
Douglas was so good at the art of the tarty skewer that he caught the attention of none other than Denton, who has become a kingmaker to aspiring Walter Winchells who have gone on to mid-six-figure book contracts (Wonkette's Ana Marie Cox) and exposure on shows such as *Access Hollywood* (Gawker's Jesse Oxfeld). Denton needed a writer for his new Silicon Valley gossip blog, wag.com, a talk-of-the-town tell tech entrepreneurs' brushes with t en deadly sins. Denton looked at a siders for the job but became con that he wanted an outsider who ha ty of courage and no relationships over a bit of chatter.

So on the weekend after Thanks Denton flew Douglas out to San Fr for an interview. The 21-year-old D had never been to the Bay Area. He know much about venture capit had not a single friend who wor Google. Perfect. Denton hired him

Less than six months later, D and Valleywag have become celebrities themselves, read by ev from the PR handlers of tech super East Coast cognoscenti trying to b hip. The blog's rise speaks to D skill at anointing nobodies and forming them into Web-lebrities– the blogosphere's inverted gra which sarcastic 21-year-olds can a scary amount of power. It also sp renewed fascination with all thin ley, given the riches arising out Web's new boom.

Valleywag strings together a m of rumor, a bit of breaking nev

stories deemed too distasteful instream media, giving the s world's high and mighty the treatment. When someone hotos of tech executives half- in costume, looking ham- or displaying obscene ges- n cameraphone shots, the show up on Valleywag. (No PR people check the site re- y.) When an underling at a lia company allegedly slips conference, revealing that made a new-media pur- Douglas pumps his Instant Mes- buddy list for speculation on what buy could have been. Add to that s like the Gorgeous Girls of and Valley Hotties, in which the men of tech are pitted against one in a hot-or-not vote. (Ben Trott, of blog toolmaker Six Apart, beat st CEO Jim Buckmaster by a argin.)



Valleywag is a stew of rumor, breaking news, and bawdy tales

scoops, Douglas courts sources Netscape founder Marc Andre- nd Craig Newmark of Craigslist. If g on the site seems false, it proba- Douglas says he's not a journalist: nal newspaper is too respectable the trash I write."

so, some marketers are still inter- buying ads on the site. Text links 00 for seven days. Denton won't revenues from other forms of ad- nent, except to say they're on par her Gawker Media blogs. After a ost-launch spike, to 100,000 view- y, Valleywag has remained steady a 30,000-person-a-day audience. ng Valley insiders, the mention of s' name can elicit a chorus of groans. Many technology executives won't admit to reading him. But many do take a peek, if for no other reason than to make sure they aren't mentioned. "He doesn't get the Valley," gripes one former venture capitalist. "Why are you giving him any attention?" growls another.

Yet in a nod to the growing power that the blog wields, neither one wishes to be named, for fear of a public smearing. "Generally speaking, it's best to avoid being written about on Valleywag if at all possible," writes Techcrunch blogger Michael Arrington in a Mar. 3 post. Arrington, whose well-read blog covers startups, says Valleywag has so far been "a source of fascination and outright fear." Initially, he tried to ignore it, he says, but after Valleywag began writing about him ("benefit-of-the-doubt giver to all startups"), he has changed course, writing: "I'm going to suck up to Nick Douglas in a big way."

Other confessed readers include Andrew Anker, founder of *Wired* and now executive vice-president of Six Apart, and Max Levchin, founder of PayPal Inc. Levchin advertises for his photo-sharing start-up, Slide.com, on Valleywag, in a deal for an undisclosed sum, and he admits to checking the blog, especially when he and his best friend, Hotornot.com founder James Hong, were both nominated for the hotties contest. Both lost, but, says Levchin, "even the fact that I'm talking about it and laughing about it indicates I pay attention."

Douglas receives two or three solid tips a day. But he never checks their veracity, just citing the source. When he's wrong, he is quick to write: "I was dead wrong." As for the rest? Douglas improvises. It's challenging to find real scoops amid the endless rumors he posts. He wrote, for example, that a certain executive at a prominent media and technology company was going to get sacked. So far, not true. But among the "he said, she said," he hits on some juicy nuggets: Ridiculing the mistakes of mainstream reporters. Covering insider romances. Posting unflattering videos. Publicizing undercovered stock sales. And chronicling the biggest bashes.

Valley insiders shrug it off, saying Douglas is a master of the obvious. That's precisely why Denton says he didn't hire an insider. Nobody was writing the stuff, he says, that everybody knows but nobody talks about. Matt Marshall, who covers technology for the *San Jose Mercury News* and writes the respected tech blog SiliconBeat, says Douglas fills a niche that has fallen to the wayside. He says that as traditional media are cutting budgets, gossip, which is so central to understanding a culture, is being overlooked.

Douglas has a yearlong contract with Gawker to post a dozen times a day, five days a week. For this, he gets enough cash to pay the $550-a-month rent for his basement room in the house he shares with 13 other people and cover expenses. Thus the brilliance of Denton's business model: Pay them (very little) and work them (all the time).

Now that the initial hype is spent, boss Denton is waiting to see how Valleywag's traffic builds. Signs are positive. Douglas advertised on the site last week for a second Valleywag writer. The beat? Coverage of Silicon Valley and its "re-inflated bubble insanity." ■

–With Sarah Lacy in San Mateo, Calif.

IO

ck Douglas

rrived in Silicon Valley plenty of courage and lationships to ruin

Apr. 12, 1984, in Lima, N.Y.

UATED Lima Christian School, 2002. mester shy of an undergraduate in English from tiny Grove City College e City, Pa.

Y Brother, 18, and sister, 13.

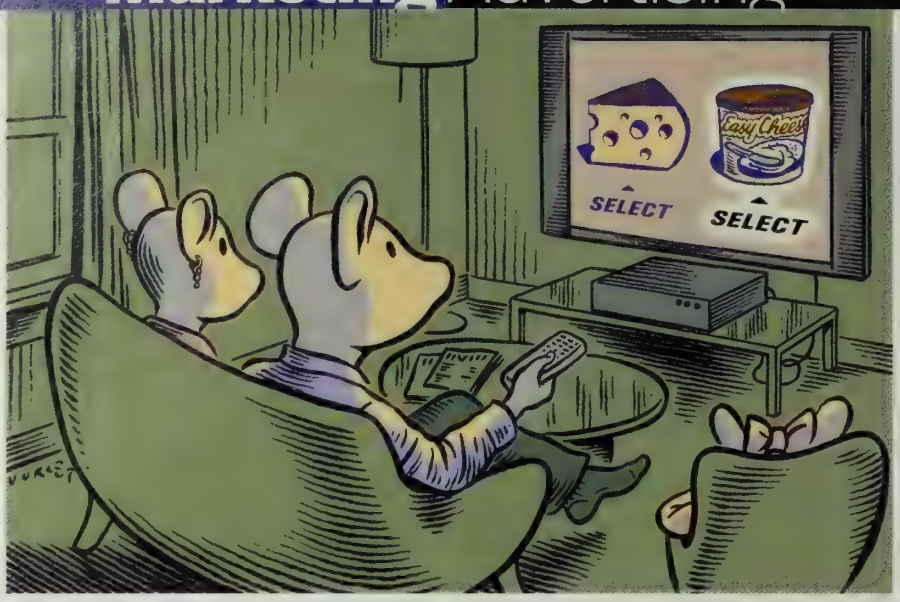
S OF HIS TRADE Alarm clock, laptop, of Smirnoff vodka.

AME Heyvalleywag; there are currently 171 people on his buddy list.

LAST WRITING JOB Volunteer news editor for Grove City's *The Collegian* (pay: none).

GAPS IN HIS ROLODEX "I need VCs and people who know VCs. I need companies like Oracle, which aren't seen as being sexy."

IDOLS Jude Law, Malcolm Gladwell, Portia de Rossi.



Learning to Love The Dreaded TiVo

How agencies are using it to make ads that viewers actually want to watch

BY DAVID KILEY

IF TV ADS ARE THE MEDIA EQUIValent of mosquitoes, then the digital video recorder (DVR) is a bug zapper on steroids. Rather than merely wringing their hands, however, ad agencies are now experimenting with the technology itself to see if DVRs can draw consumers into a deeper involvement with ads.

The latest: Next month, Sony Corp. will begin running ads for its Bravia flat-panel TVs that let viewers, if they have TiVo, choose among different endings whether they're watching live TV or a recorded program. Five seconds into the commercial, two on-screen choices appear—one aimed at men and one at women. A menu of "male" endings revolves around picture quality and size, and the "female" options focus on the TV's aesthetics. Conventional ads may be under fire, says Brad Brinegar, CEO of agency McKinney & Silver LLC in Durham, N.C., which is creating the Bravia campaign, but smart use of interactive TV could bring about an advertising renaissance. "If you provide viewers with a worthwhile experience, they'll absolutely stay engaged," he says, "and if you don't, you'll die an expensive, painful death."

TiVo Inc.'s system, with 4.4 million subscribers, is especially ripe for experimentation like this because its machine so far allows for more interactivity than cable. (Time Warner Cable Inc. now has interactive TV, and Comcast Corp. will soon unveil its version.) "Advertisers are simply trying to increase the amount of time consumers spend in their branded environment," says Davina Kent, vice-president for national sales at TiVo. Sony is even hoping that by offering 12 possible endings for its ad, viewers will be curious enough to watch them all.

That's not as implausible as it sounds. Pioneer Electronics (USA) Inc. ran a four-minute video on TiVo's Showcases system last fall that let viewers know that a longer-form video about the ins and outs of buying a plasma-screen or high-definition TV was available. TiVo says th erage staying time for such ext content is two minutes but that viewers who tapped into Pioneer's which was informational, shot in p a retail store, and not brand-sp watched the entire film.

ADS ON DEMAND

IN MAY, TIVO is rolling out wha sound like the ultimate in chut ads on demand. It's not so crazy. sumers about to spend big money o travel, new kitchens, and the like shown plenty of interest in wa video about the stuff they plan t TiVo, and the cable companies foll close behind, want to offer that c more conveniently and on viewers' TiVo's nascent broadband link to th which, among other things, conn viewer's TiVo screen with their homepage, is seen as just the begi of full-blown convergence between and the Internet.

Getting viewers to watch ad old-fashioned way is plainly g tougher. DVRs will be in 18% of h holds by yearend and 39% by 201 Nielsen Media Research. With pe tion highest among the most high-income and educated const it's no wonder that 70% of adve believe DVRs and video-on-dema "reduce or destroy" the effectiver 30-second spots, according to an of National Advertisers survey in M

Such attitudes led KFC Corp. February to try a new tack, a 30-s ad that contained a hidden m when viewers played the ad ir motion on their DVR. The rewa solving the secret was a coupon fo Buffalo Snacker sandwich. KFC' site drew 2.75 million page view the week the ad ran, 40% mor usual. And it distributed more 100,000 coupons. Still, such gim could wear thin pretty quick consumers are sig they want to skip a don't interest them not interested in t them," says Mandel, director c tal innovation at Interactive, part of & Mather Worl Even the industr dreamed up adve inside elevators a stalls of public res knows it can som go too far. ■

THE STAT

39%

of households will have DVRs by 2010. About **18%** will have the technology by the end of 2006.

Data Nielsen Media Research

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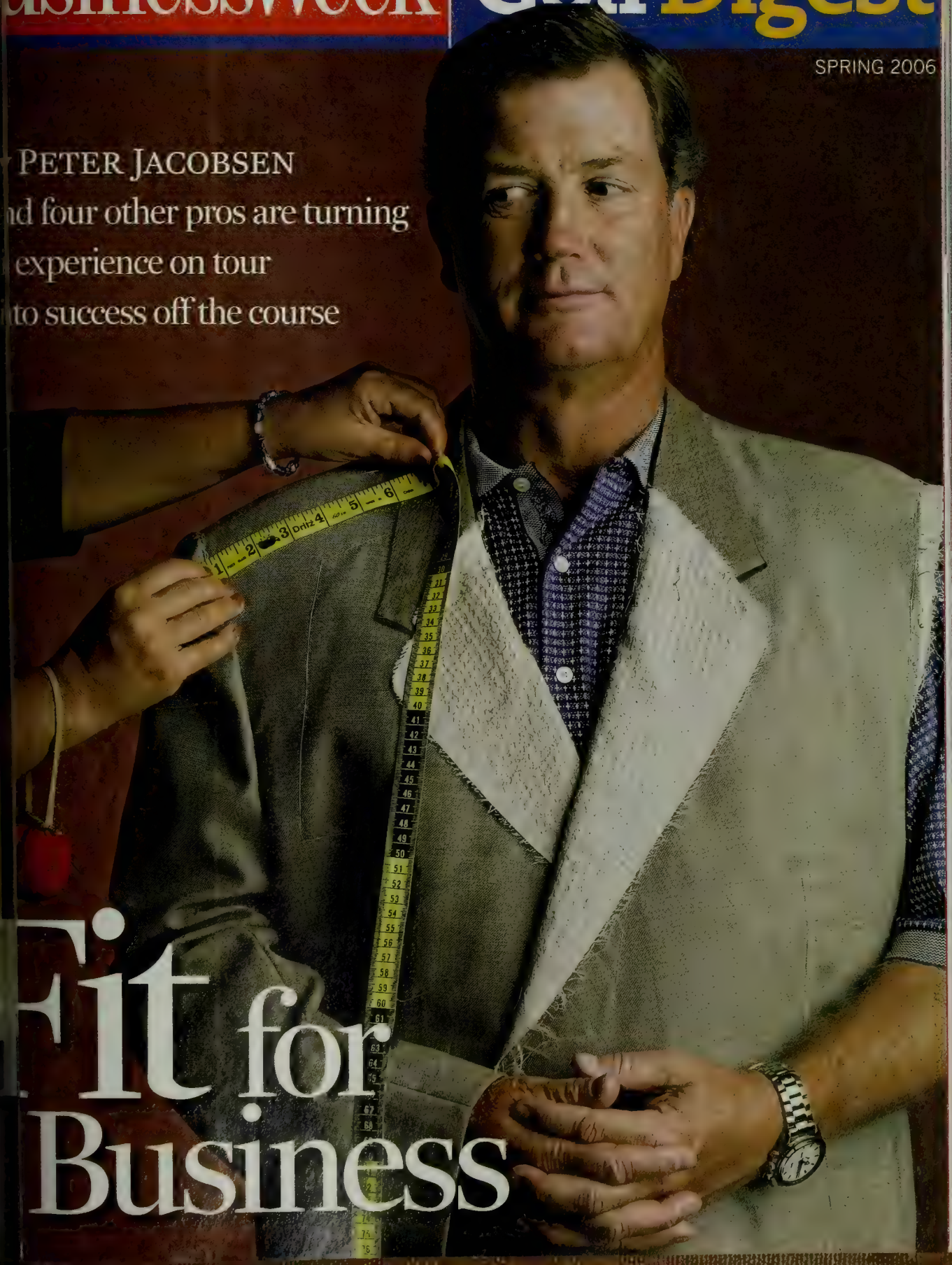
SPRING 2006

PETER JACOBSEN
nd four other pros are turning
experience on tour
to success off the course



Fit for Business

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Jerry Pate
Turf & Irrigation Inc.

Riding tall in the business world

Some tour pros, like Jerry Pate, prove ıey also can be creative entrepreneurs

:tured here with some of the products he and his ıployees distribute as part of a thriving turf care d irrigation company, Jerry Pate is just one of a ıwing number of tour pros who have translated ɜir success on the course into success in the siness world. Other tour players who followed ɜir entrepreneurial spirit include Peter Jacobsen, y Stewart, Jane Blalock, and Brian Tennyson. We l their stories on the following pages.

JERRY PATE'S education as an entrepreneur began with an introduction to legendary football coach Paul "Bear" Bryant in the early '70s and continued when he won the U.S. Open at age 22 and the Tournament Players Championship six years later.

Pate, now 52, parlayed these seminal events in his life into the Jerry Pate Cos,. a business empire that includes Jerry Pate Turf & Irrigation (one of the largest distributors of Toro products in the Southeast), Jerry Pate Golf Design (course architecture), and Wausau Farms (a turf grass company). Meanwhile, he is still playing competitive golf—in

COVER: BEN VAN HOOK; PATE: ERIC LARSON

February, he won the Outback Steakhouse Pro-Am on the Champions Tour.

Bryant was a friend of a friend of Pate's father, resulting in Pate receiving a partial scholarship to play golf at Alabama and befriending Coach Bryant.

Pate then won the U.S. Amateur at 20, turned pro a year later, and won the U.S. Open in 1976.

"All of a sudden," Pate says, "I was flying on corporate jets, doing outings for Citibank, for Mobil, playing golf with the chairman of IBM, Frank Cary. Coach Bryant knew everybody in business. When I'd go out West, I hung out at Los Angeles Country Club and Bel-Air. I was only 22 or 23. Ed Hookstratten [a high-profile attorney in Los Angeles] introduced me to some of the top people in Hollywood. Barron Hilton was a close friend of mine. I knew Bob Hope.

"They taught me a lot about business. I'd listen to them. I'd pick up on how they conducted their businesses. It's about trust and hard work. They were all classy business people, honest and fair."

Their utility to Pate was unknown until a series of shoulder injuries began derailing his golf career. In 1982, he tore cartilage in his left shoulder, an in that by 1985 required surgery. He tore his rot cuff in 1986, requiring two more surgeries. T operations in three years ended his PGA Tour ca He never approached the level of proficiency he achieved in winning eight tournaments.

In the meantime, he began working with nowned course architect Tom Fazio and event ventured out on his own. Through his design l ness Pate became familiar with Toro product 1997, Pate bought a Toro distributorship that 60 employees and revenues of $20 million. T Jerry Pate Turf & Irrigation, has 140 emplo and revenues in excess of $60 million. He has dealers in eight states distributing Toro, Echo Lawn-Boy products.

"I love business," Pate says. "If I'd never bee jured, I'd be out chipping around like my friend heart is in hitting golf balls, but the reality is, I interest in doing other things." —JOHN ST

JERRY PATE
Then and Now
Joined PGA Tour 1975

Tour highlights Won eight times on PGA Tour, including 1976 U.S. Open; 1982 TPC. Has won once on Champions Tour.
Business Jerry Pate Cos.

INJURIES FORCED PATE OFF THE TOUR, BUT EARLY CONTACTS PAID OFF

JACOBSEN'S PERSONALITY AS A PLAYER HAS HELPED IN HIS OTHER CAREER

PETER JACOBSEN's peers have dubbec the goodwill ambassador of the PGA and for good reason. The affable 52- old has never met a corporate pro-am he wou play in, and his pre-tournament clinics—whe does impressions of everyone from Arnold Pe to Craig Stadler—have made him a fan fav Jacobsen's charisma enabled him to build a g of businesses impressive for a player who, b his victory at the 2003 Greater Hartford Open gone nearly a decade without a win.

In his portfolio: a golf course design bus with noted instructor Jim Hardy tha completed 13 courses. (His company' $600,000 to $700,000 per project.) Pe cobsen Productions has overseen more 250 golf events, including a Cham Tour stop. He has endorsements with One, Lexus, and Titleist, commitment command roughly 75 days of his time year. *Golf Digest* reported in its Feb 2006, issue that these ventures gene more than $ lion in incom year, far exce the $1.04 n he earned in nament play.

Then, t

PETER JACOBSEN
Then and Now
Joined PGA Tour 1977

Tour highlights Won seven times on PGA Tour and twice on Champions Tour.
Business Peter Jacobsen Productions (tournament management, course design, television shows).

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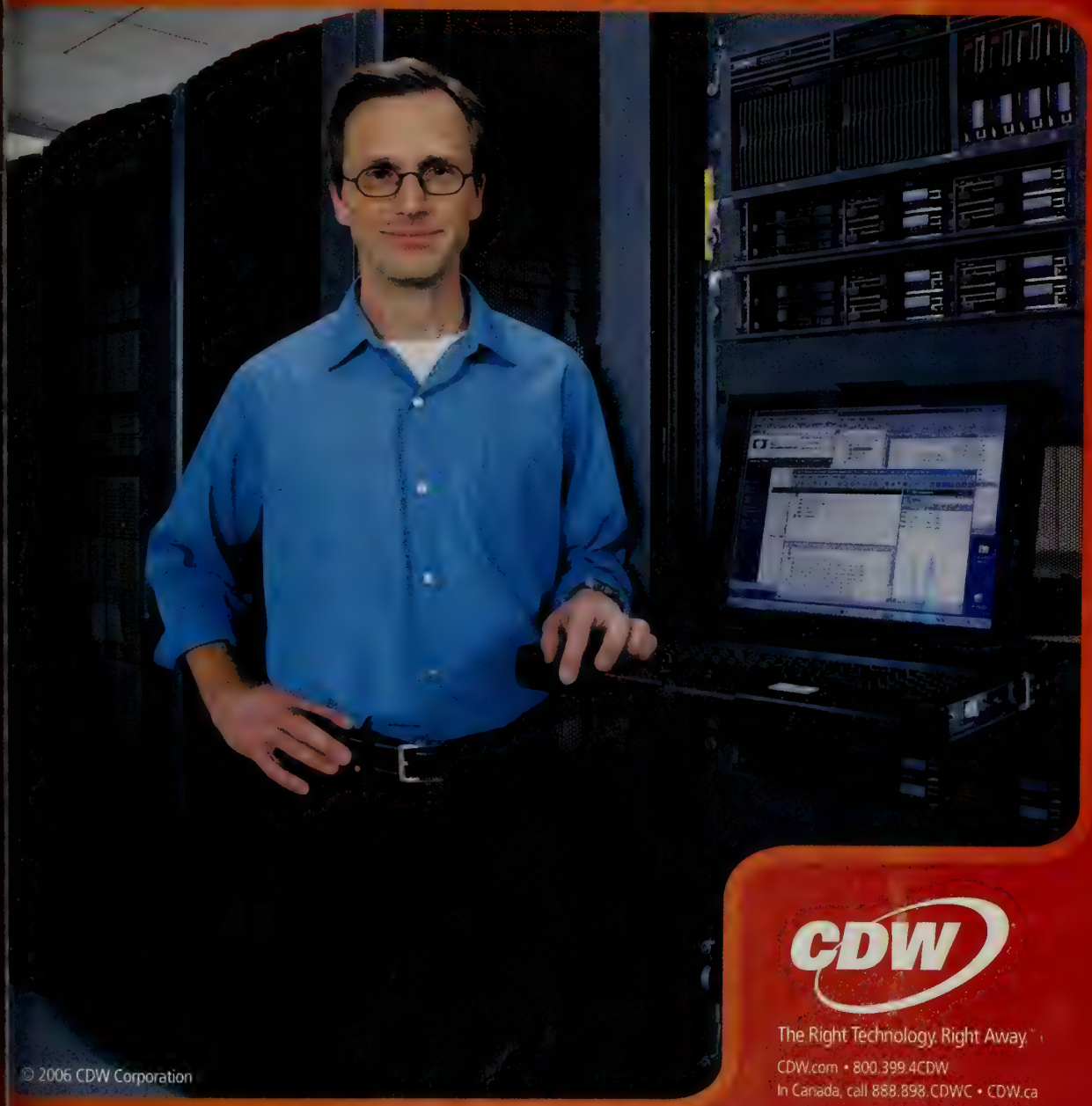

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TV: As recently as 2005, Jacobsen was starring in three shows on the Golf Channel. Though he took a hiatus this year to play more Champions Tour events, Golf Channel executives are thinking up new shows for 2007. (In one program, contestants would vie for the right to caddie for him in a Champions Tour event.)

No small accomplishment for a golfer who, as a business major at the University of Oregon, left his senior year for the PGA Tour Qualifying School with the goal of earning just enough to finish college. Even when Jacobsen earned his card on the first try and joined the tour at 21, he says he envisioned playing just a few years before going into business. "I figured if I got five years out of the tour, great," he recalls. "I was thinking business law, or maybe marketing." Jacobsen's first go at building a business came in the 1980s. With three tour wins, he attempted to bring a PGA Tour stop to his hometown, Portland, Ore. When that failed, he created the Fred Meyer Challenge, a celebrity pro-am that had a 17-year run. The event-management business he founded in recent years has directed the Jeld-Wen Tradition and the Constellation Energy Classic on the Champions Tour, the popular CVS Charity Classic outside Providence, as well as the 2003 U.S. Women's Open.

Jacobsen's entrepreneurial endeavors have put him at odds with PGA Tour officials. One of his Golf Channel shows had him playing rounds with the likes of actor Dennis Hopper and prompted the tour to demand the cable channel pay it steep rights fees, given Jacobsen's status as an active player. (The Golf Channel responded by suspending production of the series.) That riled Jacobsen, who believes the tour should be encouraging such celebrity tie-ins to attract more fans to the sport.

He also lost control of the Constellation Energy Classic in January when the Champions Tour converted the event into one of its major tournaments beginning in 2007. As a result, Jacobsen says he's switching focus to the LPGA: Just last year, he acquired Sports One Inc., which helps manage LPGA events in Portland and Phoenix. "The LPGA is still a growth opportunity for everybody," he says. Which means that Jacobsen will be bringing his show to a new audience. —DEAN FOUST

RAY STEWART is a professional golfe understands that a bad decision can costly. His trade also has taught hin to recover from a dubious position. So it wa Stewart, 52, turned a questionable investmen British Columbia medical equipment compan a profitable business that has eased the uncer of entering his senior years without a Cham Tour exemption.

"I invested a lot of money with a friend of n he says. Make that an ex-friend. "I was misle

This was in January, 2001. Two months Jamieson Healthcare began to unravel, and

STEWART MET WITH LIMITED SUCCESS ON TOUR, BUT HIS MEDICAL-EQUIPMENT COMPANY IS GOING STRONG

RAY STEWART
Then and Now
Joined PGA Tour 1983

Tour highlights Won twice on Canac Tour; played in a World Cup for Ca and two Dunhill Cups (won in '94 **Business** Stewart Medical Inc. (se used medical equipment worldw

it, Stewart's investment. By October, 2002, I become the sole owner of the company, whi came Stewart Medical Inc., an Abbotsford concern that sells used medical equipment the world.

"I didn't know anything about anythin says of his business acumen then. "I found o quickly that the more money you've invest faster you're going to learn. I sold a heart-an machine to China, a bone densitometer to America. It's a huge business. There are tho of dealers in the U.S."

Most of his business is international, p larly Third World. He does about one-t his business in Canada, which has gover funded health care and purchases its equi

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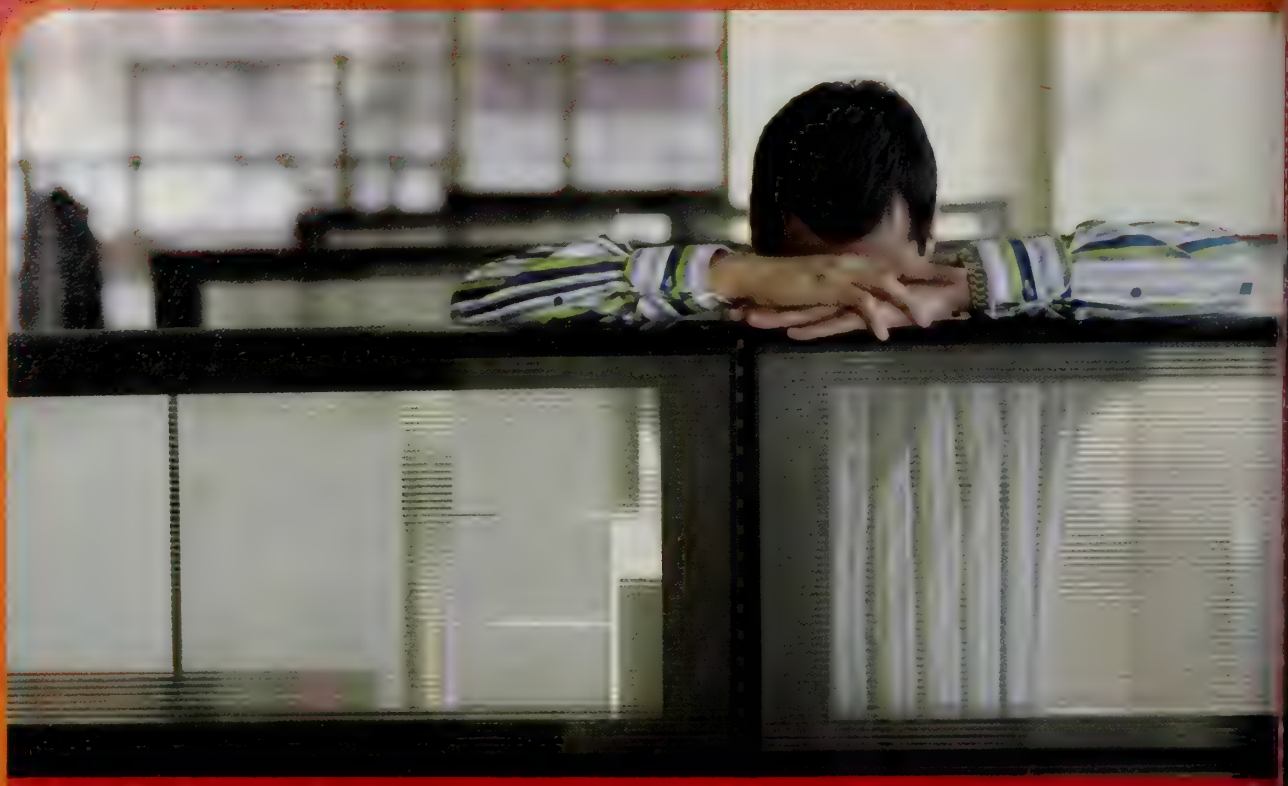

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[1] Eligible processors include Intel Pentium II, III or Intel Celeron Processor; AMD processors do not qualify; trade-in values are estimates only; actual trade-in values may vary from $100 to $500; all products mu
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  - Intel® Pentium® M Processor 750 (1.86GHz)
  - Intel® PRO/Wireless 2915 Network Connection (802.11a/b/g)
- Memory: 512MB
- CD-RW/DVD-ROM combo drive
- 14.1" active-matrix display

HP vp6320 Digital Projector

- 2000 ANSI lumens XGA projector
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- Intel® PRO/Wireless 2200 Network Connection (802.11b/g)

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40GB hard drive
CD-RW/DVD-ROM combo drive
15.4" active-matrix display

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-200 TRADE-IN
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HP L1940 Monitor

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JANE BLALOCK
Then and Now
Joined LPGA Tour 1969

Tour highlights Won 27 LPGA tournaments, including 1972 Dinah Shore Colgate Winners Circle. Won $192,426 in 1985, her last full year on tour.
Businesses JBC Golf which runs LPGA clinics, The Jane Blalock Golf Academy, The Legends Tour, and event marketing.

new. "I take their surplus stuff and resell it," he says.

Stewart, a British Columbia native, played eight years on the PGA Tour, earning nearly $275,000 in his two best seasons, 1989 and 1990, and finishing second in the Chattanooga Classic in '89, tying his best finish on the U.S. tour. He won twice on the Canadian Professional Golf Tour, and represented his country on two Dunhill Cup teams, winning in '94, and one World Cup team.

Golf has helped him in business in one important regard: "A lot of doctors play golf," he says. "The business fits very well with the game."

Another significant part of his business has been renting medical equipment to the movie industry. British Columbia has become a less expensive alternative to filming in the U.S., creating a growing industry. Stewart's medical equipment has appeared in *Final Destination 2*, and WB's *Smallville*.

Stewart has not abandoned the notion of returning to tour golf. He qualified for and played in only one event in 2005, the Senior British Open, and tied for ninth, earning $33,339. It was a result that indicates he can still compete, given the chance. He made it to the final stage of Champions Tour, qualifying at the end of the year, but tied for 21st and failed to secure playing privileges. He will try to qualify again in the fall, either on the tour or the European Seniors.

"I'm not quite done yet," he says. —JOHN STREGE

JANE BLALOCK made her move from the Tour to Merrill Lynch's Boston office in after her most lucrative year as a tour pro. people thought she was simply trading profes golf for window dressing. Instead, after 27 wir more than $1.2 million in earnings, Blalock w a new way to keep score. "I thought how gr would be to go out at the top of my game," she "I always had a yearning for business, and I w to try something completely different."

Contacting an acquaintance who had aske to keep in touch if she ever thought about a change, she tackled broker certification wit same intensity she brought to golf as a New H shire amateur, Rollins College standout, and star. "It was the scariest and the smartest thir ever done," she says. "I treated the Series 7 like a competition I wasn't going to lose."

Her transition to the business world requ mental adjustment, she admits. "I v longer being coddled," she says. "It asking, 'What can I do for you?' inst 'What can you do for me?' "

BLALOCK GOT A BROKER'S LICENSE THEN PURSUED A NEED TO DO SOMETHING CHARITABLE

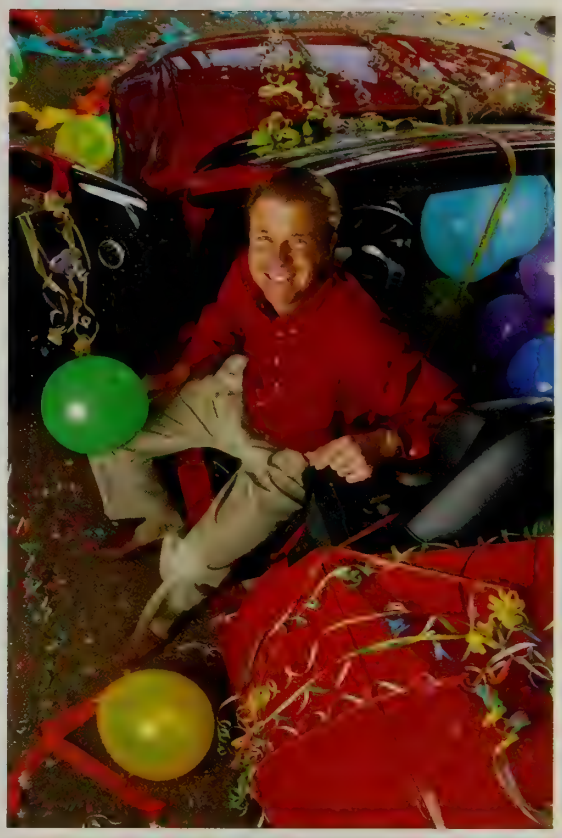
Rather than flip through business collected during LPGA pro-ams, E built a client base by networking a Boston. "I even joined a tennis clut laughs. Inspired to strike out on he in part by reading Bill Gates's ad "deal from personal strength," Blalock hit a way to fill a need she felt to be creative an something charitable. Soon she was running rate-sponsored women's golf clinics that be the Susan G. Komen Breast Cancer Foundat

That was the start of the Jane Blaloc launched in 1987, even as its namesake contir work as a broker. Last January, with annual re of roughly $2 million, the company becan Golf. Under its umbrella are the LPGA Golf previously title-sponsored by Mazda then but now underwritten by multiple sponsors ing Fidelity Investments, PricewaterhouseC IBM, Toshiba, Staples, and American Airline are conducted for women in 15 cities acr U.S. In addition, there's the Jane Blalock Gol emy, where executive women can hone g business skills; corporate golf event manag which she refers to as "private-label event the LPGA's senior circuit—the recently re Legends Tour, for which she serves as twic

president and paid marketing sultant. (Successes include a nt three-year contract with BJ's olesale Club that will generate million for charity along with 0,000 in annual prize money.) ock has eight employees work- at events or in her Cambridge ss.) office and plans to hire e staff this year.

When I turned 60 last fall," Blalock, "I decided I could d up or slow down." When decided to speed up to foster vth, she sought investors she'd through her networking efforts: Temple, a venture capitalist; lis Godwin, chairman and CEO Quincy (Mass.)-based Granite Electric; and Sally Susman, utive vice-president for global munications at Estée Lauder.

ocused as Blalock is on build- her business and signing new ts, she remains intent on gener- money for charity. "I wake up y morning with a purpose," she "It's a chance to make a differ- . It has nothing to do with my account." —LISA FURLONG



BRIAN TENNYSON
Then and Now
Joined PGA Tour 1987

Tour highlights 29th on money list in 1990, with $443,508.
Businesses Ash-Allmond Associates (marketing); Complete Fleet Solutions (company vehicle repair and maintenance).

BRIAN TENNYSON, as an undergrad at Ball State University in Muncie, Ind., made one of those fateful connections with a room- that would transform his life after golf. In 1984 wo went their separate ways as Tennyson began uing his dream of winning a PGA Tour card and oomie, John Schnatter, went off to run a biker alled Mick's Lounge outside Louisville.

nnyson qualified for the tour in 1987. Thanks econd-place tie at the 1990 Bob Hope Chrysler ic behind Peter Jacobsen and a runner-up finish e old Hardee's Classic, he finished 29th on the ey list that year with $443,508.

t when a balky putter and a neck injury caused to start missing cuts in 1992, Tennyson took up iend's offer to join a fledgling pizza chain that atter had named after himself: Papa John's. the next year, Tennyson went from owning John's franchises in the Akron region to joining the parent company as vice-president for strategic planning. When Schnatter began exploring ways to expand, Tennyson encouraged him to do a public stock offering. "I still remember traveling around the country doing the road shows with investors," he says. "It was a great ride."

After Papa John's went public in 1993, Tennyson became its first head of investor relations. But within two years, the 80-hour work weeks started getting to him. Finally, he got his wife's blessing to leave the financial security of Papa John's and attempt a return to the tour in 1995.

Unfortunately, Tennyson did not fare as well during his second stint. After a brief return to the Asian Tour, where he had started after college, he played on the PGA Tour in 1996 but lost his slot the following year. By 2001 he knew it was time to quit. But he also knew his Papa John's experience gave him the skills to make it again in business.

TENNYSON KNEW HIS PAPA JOHN'S EXPERIENCE WOULD SEE HIM THROUGH A SECOND SHOT AT BUSINESS

Working as a studio analyst for the Golf Channel and Fox Sports Net helped Tennyson stay in the game, even as he cast around for a new venture. "I probably looked at 500 businesses," in every area from restaurants to waste management, he says. Today he's a partner in a small, Dallas-based marketing outfit, Ash-Allmond Associates, that manages regional sweepstakes for such clients as Frito-Lay, he says with pride. He is also starting up a new venture in his hometown of Evansville, Ind.—Complete Fleet Solutions Inc.—which dispatches mechanics to maintain and repair vehicles at company sites. About his years on tour, he says, "I was never great, but I always found ways to get better." He says he's taking that approach to business as well. —DEAN FOUST

BusinessWeek online For a story on golf pro Danny Edwards' business endeavors, go to www.businessweek.com/extras

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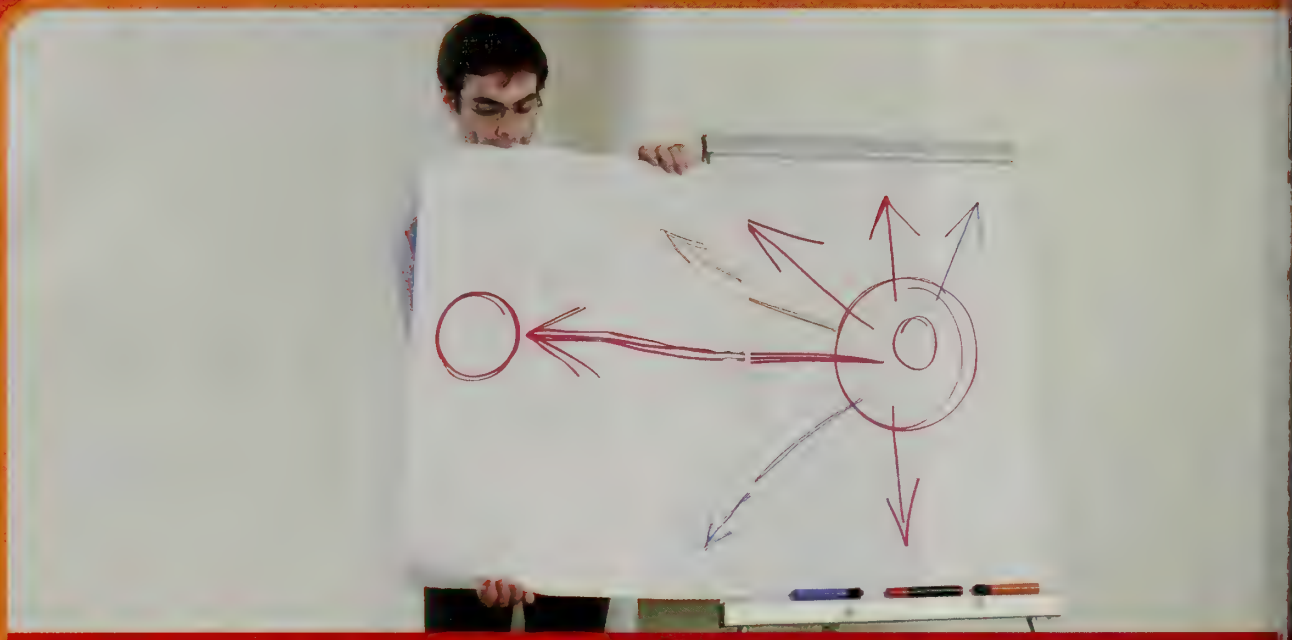

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BY GENE G. MARCIAL

LIQUID-CRYSTAL DISPLAYS ARE BRIGHTENING UP CORNING.

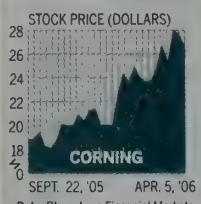
CAN ASPECT MEDICAL TAKE ON ALZHEIMER'S AND DEPRESSION?

WHY BAD DEBTS ARE EVEN BETTER NEWS AT ASTA FUNDING.

rning Turns a Corner

HE LATE 1990S, WHEN TECH and telecom stocks d, Corning (GLW) soared—from 14 a share in early 9 to 113 in 2000. But then the fiber-optics market and Corning crashed to 1.10 in late 2002. After three rs, Corning bounced back by its focus to the liquid-crystal s. It became the world leader of n glass panels for the liquid-displays used in TVs, notebook ers, and flat-panel desktop rs. Liquid-crystal sales, now total revenues, should expand of 40% and 50% in 2006 and alysts figure, based on the g demand for larger TV and er screens. The turnaround he stock up from 12 in 2005 to The recovery is impressive—as are Corning's new ncluding enhanced fiber optics and cable, says Lee eis, CEO of Alpha Hedged Strategies Fund, which ares. By more than doubling in a year, the stock has its peers, notes Schultheis, who sees it reaching 33 in months. Corning's solid performance, he says, reflects g fundamentals. New technologies, such as "green o eliminate toxic chemicals in liquid crystals and a laser" to remove impurities from water and fuel cells, tain Corning's momentum, Schultheis argues. For the e since 2000, Corning was in the black in 2005 and t up a cash stash of $2.4 billion. John Harmon of ent bank Needham recently upped his 2006 sales e from $5.6 billion to $5.7 billion and his earnings from $1.10 a share to $1.11. For 2007, he raised his s from $6.8 billion to $7.1 billion and from $1.28 to hese forecasts reflect the improved liquid-crystal says Harmon, who rates the stock a "buy."

THE DARKNESS IS PAST

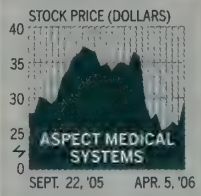


Data: Bloomberg Financial Markets

esh Prospect Aspect

IE INVESTORS ARE STARTING to see Aspect Medical stems (ASPM), tops in brain monitoring, in a new ht. Its technology lets clinicians assess a patient's level iousness to judge the right amount of anesthesia to ter. Now, Aspect may be on to something more : its technology's potential for treating Alzheimer's disease and depression. Mark Garfinkel of Trusco Capital Management, which owns shares, says Aspect is making headway in clinical trials, co-funded by Boston Scientific, that use its monitors in managing depression. Boston Scientific owns 28% of Aspect. Suraj Kalia of investment firm Rodman & Renshaw says these potential applications "could increase Aspect's attractiveness as a potential takeout candidate." Charles Olszlewski of Oppenheimer Funds expects profits of 61¢ a share in 2006 and 65¢ in 2007, up from 35¢ in 2005. The stock, now at 28.50, is surely a "buy," he asserts.

IN NEED OF RECOVERY



Data: Bloomberg Financial Markets

Asta Is Really Collecting

BUYING DISTRESSED DEBT from credit-card companies and auto dealers may be a stressful business, but not to Gary Stern, CEO of Asta Funding (ASFI), who pays just pennies on the dollar for such loans. Asta's stock has been on a roll. Since being featured here on May 2, 2005, when it was trading at 20, the stock has soared to 33. Surging revenue growth of 46.5% and a profit leap of 49% in 2005 propelled the stock upward, says Steven DeLaney of Flagstone Securities, who tags the stock a "buy." Despite the sharp rise, Asta remains attractive, he argues. Audrey Snell of ThinkEquity Partners, also a bull on Asta, raised her estimates after the company reported a "very strong" December quarter. In that period, Asta bought $2.1 billion in receivables for just $102.4 million. She lifted her earnings forecast for the year ending Sept. 30, 2006, from $2.60 a share to $2.70. For 2007, she expects $2.86. Ivan Feinseth of securities outfit Matrix USA, who upgraded Asta from "hold" to "buy," says Asta's stock has an intrinsic value of 47. ■

ON THE UP AND UP

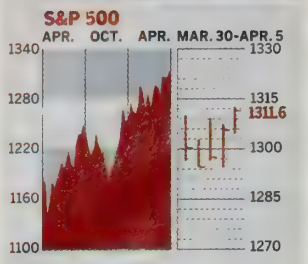
Data: Bloomberg Financial Markets

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

Personal Business Figures of the Week

STOCKS



COMMENTARY

Wall Street greeted April with open arms, carrying over the rally that began in the first-quarter. The NASDAQ set new five-year highs almost daily, as investors flocked to shares of Google, Apple, and Qualcomm. Meanwhile, metals outfits such as Phelps Dodge and Alcoa soared higher still. The market's strong move came despite rising interest rates and higher oil.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	APR. 5	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1310.8	0.6	5.0	11.0
Dow Jones Industrials	11,233.0	0.2	4.8	7.4
NASDAQ Composite	2356.9	0.8	6.9	17.9
S&P MidCap 400	798.1	0.8	8.1	21.2
S&P SmallCap 600	395.5	0.4	12.8	23.1
DJ Wilshire 5000	13,250.4	0.6	6.0	13.8

SECTORS

BusinessWeek 50*	791.7	1.8	6.7	12.5
BW Info Tech 100**	404.2	2.1	6.2	15.6
S&P/Citigroup Growth	615.5	0.3	3.2	7.9
S&P/Citigroup Value	692.3	0.9	6.9	14.1
S&P Energy	416.4	1.7	11.7	22.9
S&P Financials	443.9	0.9	4.1	16.8
S&P REIT	171.2	-3.2	11.9	30.3
S&P Transportation	285.2	3.2	14.1	27.3
S&P Utilities	158.7	-0.3	-0.6	5.9
GSTI Internet	198.0	1.8	-3.5	24.4
PSE Technology	880.0	0.5	5.2	22.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	APR. 5	WEEK	% YEAR T DATI
S&P Euro Plus (U.S. Dollar)	1713.3	3.4	13.
London (FT-SE 100)	6044.1	1.4	7.
Paris (CAC 40)	5221.0	0.8	10.
Frankfurt (DAX)	6029.2	1.9	11.
Tokyo (NIKKEI 225)	17,244.0	1.8	7.
Hong Kong (Hang Seng)	16,100.1	2.3	8.
Toronto (S&P/TSX Composite)	12,273.2	0.7	8
Mexico City (IPC)	19,880.7	3.9	11

FUNDAMENTALS

	APR. 4	WEEK AGO
S&P 500 Dividend Yield	1.72%	1.79%
S&P 500 P/E Ratio (Trailing 12 mos.)	18.2	17.9
S&P 500 P/E Ratio (Next 12 mos.)*	14.8	15.1
First Call Earnings Surprise*	16.70%	2.79%

TECHNICAL INDICATORS

	APR. 4	WEEK AGO
S&P 500 200-day average	1244.4	1242.1
Stocks above 200-day average	69.0%	67.0%
Options: Put/call ratio	0.76	0.78
Insiders: Vickers NYSE Sell/buy ratio	5.22	5.51

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Divsfd. Metals & Mining	20.6	Steel	79.1
Steel	20.0	Divsfd. Metals & Mining	78.2
Constr. Materials	17.6	Oil & Gas Equip.	71.5
Agricultural Products	15.2	Oil & Gas Refining	64.0
Electric Mfg. Svcs.	9.8	Constr. Materials	62.9

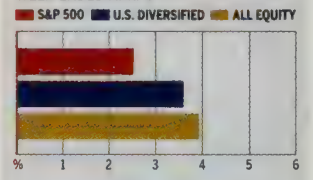
WORST-PERFORMING GROUPS

	LAST MONTH %	
Health-Care Supplies	-4.7	Automobiles
Health-Care Equipment	-3.9	Home Furnishings
Consumer Finance	-3.8	Broadcasting
Semiconductor Equip.	-3.7	Health-Care Faciliti
Power & Energy Traders	-3.5	Diversifed Chemica

MUTUAL FUNDS

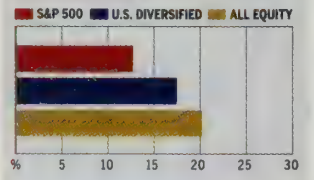
4-WEEK TOTAL RETURN

WEEK ENDED APR. 4



52-WEEK TOTAL RETURN

WEEK ENDED APR. 4



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	11.4	Latin America	82.5
Japan	11.4	Precious Metals	69.0
Diversified Pacific/Asia	9.3	Diversified Emerg. Mkts.	51.6
Natural Resources	8.7	Japan	44.1
LAGGARDS		**LAGGARDS**	
Health	0.1	Domestic Hybrid	9.8
Utilities	1.4	Large-cap Value	13.1
Domestic Hybrid	1.9	Large-cap Blend	13.2
Real Estate	2.7	Miscellaneous	13.2

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Frontier MicroCap	26.3	ProFunds Ultra Japan Inv.	111.4
American Heritage Grth.	25.0	U.S. Global Invrs. Gold	96.9
ProFunds Ultra Japan Inv.	24.1	Midas	94.4
iShares MSCI S. Afr. Idx.	17.7	ING Russia A	91.0
LAGGARDS		**LAGGARDS**	
Ameritor Investment	-16.7	Ameritor Investment	-68.8
Potomac Sm. Cap/Sh. Inv.	-10.3	Potomac Sm. Cap/Sh. Inv.	-37.0
ProFds. USh. Sm. Cap Inv.	-10.2	ProFds. USh. Sm. Cap Inv.	-35.8
ProFds. Sh. Prc. Mtls. Inv.	-9.9	ProFunds UltraSht Mid Cap Inv.	-30.1

INTEREST RATES

KEY RATES

	APR 5	WEEK A
Money Market Funds	4.25%	4.20
90-Day Treasury Bills	4.66	4.62
2-Year Treasury Notes	4.80	4.80
10-Year Treasury Notes	4.84	4.81
30-Year Treasury Bonds	4.89	4.84
30-Year Fixed Mortgage †	6.33	6.29

†Bar

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Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND
General Obligations	4.02%
Taxable Equivalent	5.74
Insured Revenue Bonds	4.10
Taxable Equivalent	5.86

THE WEEK AHEAD

INTERNATIONAL TRADE *Wednesday, Apr.12, 8:30 a.m. EDT* » The February foreign trade deficit is expected to be $67.9 billion. That's the median forecast of economists polled by Action Economics. The trade gap jumped to $68.5 billion in January.

FEDERAL BUDGET *Wednesday, Apr 12, 2 p.m. EDT* » The federal government probably ran a $74 billion deficit in March after a $119.2 billion shortfall in February.

RETAIL SALES *Thursday, Apr. 13, 8:30 a.m. EDT* » Retail sales most likely fell 0.6% in March, following a drop of 1.4% in February. Less auto sales, the March gain was probably 0.5%, after a 0.6% dip the month before.

EXPORT-IMPORT PRICES *Thursday, Apr. 13, 8:30 a.m. EDT* » March export prices very likely ticked up 0.1% after holding steady in February. Import prices probably bounced back 0.3%, following a 0.5% drop in the previous period.

BUSINESS INVENTORIES *Thursday, Feb. 14, 10 a.m. EDT* » December inventory levels probably rose 0.3%.

INDUSTRIAL PRODUCTION *Friday, Apr. 14, 9:15 a.m. EDT* » March factory output is forecast to have grown 0.4% after a 0.7% rise in February. The average operating rate likely climbed to 81.4%, from 81.2%.

The *BusinessWeek* produ climbed to 269.7 for the w Apr. 25, a gain of 12.8% f ago. Before calculation o week moving average, the to 271.6.

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ompany Index

dex gives the starting page for a story or feature with a ant reference to a company. Most subsidiaries are indexed under vn names. Companies listed only in tables are not included.

8
e & Fitch (ANF) 30
ACN) 48

s (AGE) 74
) 28
n 36
ed Strategies
3
n (AMZN) 40
30, 91
.) 28
rch 76
91
cal (ASPM) 103
g (ASFI) 103

62

50

z 36
esco 66
CS) 25, 66
s (BSC) 66, 74
s (UL) 30
(BBI) 12

20, 30
ntific (BSX) 103
36
s (BMY) 11

8
Ellis 25
8
LJ) 60
pital 11, 28
IB) 34
sor 40
wab (SCH) 66
X) 80
) 16, 66
11, 28, 54, 66, 91
) 110
O) 66
man (CKC) 80
ctures (SNE) 64
MCSA) 22, 58, 88
et 91
ciences (CSC) 28,

CAL) 30
V) 103
T) 30
pers 24

(CSR) 74
1

Chrysler (DCX) 30
(DE) 48
18
0
Q) 28
es (DALR) 28
nk (DB) 110
sources 84

Domino's Pizza (DPZ) 30
DreamWorks (VIA) 64
Dubai Ports World 110
DuPont (DD) 66

E
eBay (EBAY) 40
EDS (EDS) 48
Eli Lilly (LLY) 11, 84
Emerson Electric (EMR) 74
ENI (E) 28
Enron 84, 112
Ericsson (ERICY) 28
Estée Lauder 91
EXL 48
ExxonMobil (XOM) 66, 84, 91

F
Fannie Mae (FNM) 45
Fidelity 28, 66, 91
Flextronics (FLEX) 48
Ford (F) 16, 30, 80
Forrester (FORR) 48
Fox (NWS) 64
Frito-Lay (PEP) 91

G
Gartner 48, 54
Gawker Media 86
GE (GE) 48, 66, 74, 80
General Atomics 45
Genpact 48
Glenmede Trust 76
Global Hyatt 30
Glovis 82
GM (GM) 16, 28, 80
GMAC (GM) 11, 28
Goldman Sachs (GS) 66
Google (GOOG) 40, 86
Granite City Electric 91
Grapevinehill 40
Guidant (GDT) 60

H
HBO (HBO) 12
Hewlett-Packard (HPQ) 28, 48, 66
Hexaware Technologies 48
Hirschfeld Steel 45
H.J. Heinz (HNZ) 30
Home Depot (HD) 60, 66
Hotornot.com 86
Hyundai 80, 82

I
IBM (IBM) 28, 48, 91
ICBC 66
iflex solutions 48
Infosys (INFY) 48
Intel (INTC) 22, 66
ISI Group 66

J
J&J (JNJ) 60, 66
JBC Golf 91
J.D. Power (MHP) 50
Jeffries 28
Jerry Pate 91
JPMorgan Chase (JPM) 25

K
KFC (YUM) 88
Kia 80, 82
Kmart (SHLD) 14
Knight Ridder (KRI) 24
Korn/Ferry (KFY) 80

L
Levi Strauss 80
Lexus (TM) 50
Lucent (LU) 28
Lyster Watson 66

M
Marriott (MAR) 30
Martin Agency (IPG) 24
Matrix USA (MUSA) 103
McDonald's (MCD) 14, 30, 62
McKinney & Silver 88
Mercedes (DCX) 50
Merrill Lynch (MER) 76, 91
MFS Emerging Markets 66
Microsoft (MSFT) 28, 30, 66
MicroWorld 54
Miller Brewing 30
Mine Safetry Appliances 36
Miyasaka Brewing 52
Molson Coors (TAP) 30
Moody's (MCO) 66
Morgan Stanley (MS) 60, 64, 76
Motel 6 84
Motorola (MOT) 22
MphasIS, 48
MSN (MSFT) 16
Muhlenkamp Fund 66

N
NCR (NCR) 34
Netflix (NFLX) 12
New York Times (NYT) 24
Nike (NKE) 30
Nortel (NT) 28
Northrop (NOC) 16

O
Oak Associates 66
OfficeTiger 48
Ogilvy & Mather (WPPGY) 88
Oppenheimer (OPY) 103
Oracle (ORCL) 48
Outback Steakhouse (OSI) 91

P
P&G (PG) 30, 66, 80
Panera Bread (PNRA) 62
Papa John's (PZZA) 91
Paramount (VIA) 64
Parsons Transportation 45
Patni Computer 48
PayPal (EBAY) 86
PDVSA 28
Pfizer (PFE) 66
Pioneer Electronics 88
Polaris Software Lab 48
Porsche (PSEPF) 50
Precursor 58
PricewaterhouseCoopers 91

Q
Quorvis 84

R
Raymond James (RJF) 62
Revenue Solutions 34
Rodman & Renshaw 103
R.R. Donnelley (RRD) 48

S
Sandelman Associates 62
S&P (MHP) 66
Sasken 48
Sears Holdings (SHLD) 14
Sharp (SHCAY) 22
Siemens (SI) 28
Sierra Nevada Brewing 30
Silicon Image (SIMG) 22
Sitrick 84
Six Apart 86
Slide.com 86
Sony (SNE) 88
Sophos 54
Southwest (LUV) 20
Sports One 91
Staples (SPLS) 91
Stewart Medical 91
Swiss Re 110

T
Target (TGT) 14, 30
TCS 48
Teradata (NCR) 34
ThinkEquity Partners 103
Thomson (TOC) 76
Threat & Risk Associates 54
Three-Forty Communications 40
3M (MMM) 36
Time Warner Cable (TWX) 88
TiVo (TIVO) 88
Toshiba (TOSBF) 91
Total (TOT) 28
Trend Micro 54
Trump Mortgage 12
Trusco Capital 103

U
UBS (UBS) 58
United Airlines (UAUA) 30
United Technologies (UTX) 74
Universal Pictures 64
U.S. Steel (X) 16

V
valleywag.com 86
Verde Group 14
Verizon (VZ) 58
Viacom (VIA) 64
Volkswagen 50

W
Wal-Mart (WMT) 11, 14, 30, 60, 66, 84
Walt Disney (DIS) 30, 66
Washington Post (WPO) 24
Wendy's (WEN) 30
Wilh. Wilhelmsen 82
Wipro (WIT) 48
WNS Global Services 48
World Sake Imports 52

X
Xerox (XRX) 78

Y
Yahoo! (YHOO) 16, 40

Z
Zensar Technologies 48

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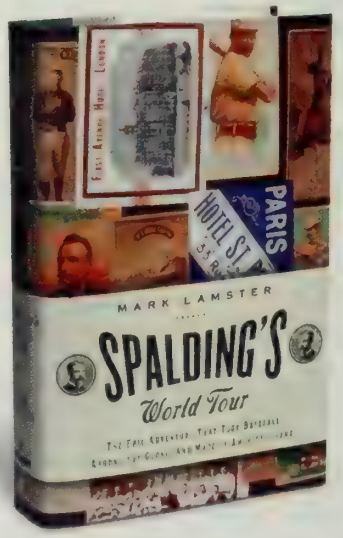
The Greatest Game on Earth

SPALDING'S WORLD TOUR **The Epic Adventure That Took Baseball Around the Globe—And Made It America's Game**
By Mark Lamster; PublicAffairs; 341pp; $26

In 1888 a rambunctious band of American pro baseball players led by Albert G. Spalding, sports impresario extraordinaire, embarked on a six-month barnstorming tour of the world. Spalding conceived of this expedition not merely as a way of promoting baseball abroad but also of demonstrating the superiority of the American way. As the "American game par excellence," in Spalding's view, baseball was the very embodiment of "American Courage, Confidence, Combativeness; American Dash, Discipline, Determination"—and so on through the alphabet to "Vim, Vigor and Virility."

The ensuing events are nicely chronicled in Mark Lamster's entertaining *Spalding's World Tour: The Epic Adventure That Took Baseball Around the Globe—And Made It America's Game.* Thanks to the recent World Baseball Classic, which showcased national teams from 16 countries, this narrative drawn from Major League Baseball's formative years is as timely as this morning's box scores, though superpatriot Spalding no doubt would have been appalled that America's team finished behind Japan, Cuba, South Korea, and the Dominican Republic.



Born in Illinois in 1850, Spalding is a largely forgotten figure who nonetheless played a leading role in professionalizing what was in his boyhood nominally still an amateur sport. A superb pitcher who in his best year compiled an astounding 55 wins against just 5 losses, Spalding excelled first as the playing manager and later as the owner of the Chicago White Stockings. He was instrumental in forming the National League and built an eponymous company founded with a borrowed $800 into a hugely profitable sporting-goods empire that survives to this day, albeit in diminished form.

Although Spalding was a man of genuine accomplishments, he was prone to compulsive exaggeration and fabrication. There was no fact so simple or straightforward that "baseball's Barnum" would not try to twist to promotional advantage, contends Lamster: "All of Albert Spalding's successes—and they were legion—were built on deceptions, some of them small, others spectacularly elaborate." He skips over some of these transgressions too lightly in his eagerness to move his story forward and devotes far too little space to Spalding's business machinations. All in all, though, Spalding is so compelling a character that he is sorely whenever he's not front and center.

Spalding had to dig deep into his promoter's bag to pull off his World Tour. His Chicago players were no real choice, but the impresario struggled to field a of All-Stars willing to join the White Stockings on w falsely billed at first as a relatively quick voyage to A In those days, most players worked during the off-se make ends meet, and the $50-a-week Spalding was "would not have been cigar money," as one player p It was only after the expedition had safely landed D Under that Spalding pretended to let the players tall him into heading east to Asia instead ing home.

Lamster knows his baseball and pro his accounts of games played on make diamonds in all kinds of weather befo crowds ranging in attitude from hostil Naples spectators stormed the field aft of their number was knocked cold by a ball) to befuddled admiration (Melbou Glasgow were especially welcoming). *Spalding's World Tour* is as much trave as sports history and is all the better f Although at times the Americans wen through the motions on the playing fie travelers they proved to be consistentl engaged, making up in curiosity what lacked in sophistication as they toured Hawaii, New Zealand, Australia, Ceylo Egypt, Italy, France, England, Scotlan and Ireland.

Spanning the globe with "baseball's Barnum"

This book abounds with pr vivid set pieces that evoke a va world of luxury liners and eig banquets, a world unspoiled b advent of mass tourism. Lams account of a grand luau at the of the pudgy, baseball-loving l Kalakaua of Hawaii is particu well-rendered. The Americans fearing cannibals but left entr the king's hula dancers.

In the author's estimation, voluminous and generally favorable publicity afford Spalding's world tour in the U.S. did more to solidify baseball's popularity at home than it did to inspire fo to take up the game. In part, this was because Spaldi players were so brilliantly skilled that "they left the d impression that the game was so difficult that any att challenge American superiority, honed over generati would be forever hopeless." Oh, how times have char

–By Anthor

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What Bill Is Thinking

FORMER PRESIDENT BILL CLINTON has been spending his time drumming up funding and attention to combat many of the world's greatest ills. World poverty, AIDS, religious conflicts, and public health care are just some of the priorities of his Clinton Global Initiative (CGI), and the President's foundation so far has raised about $2.5 billion from business leaders and institutions. But Clinton has also been thinking deeply about American competitiveness in a global marketplace. He spoke favorably of an idea "floating around the Senate" under which the government would assume some of the health-care legacy costs weighing on U.S. auto makers.

SNAPSHOT

I FEEL FINE and am trave lot. I've been to 12 countri doing the foundation work I was blessed. I dodged a bullet, and I am trying to with child obesity to spar others the heart problem have developed. I feel great . . . and, yes, I play th little bit and golf. I built m music room up here [in Chappaqua] . . . and just got a tenor sax

What are the top priorities of the CGI?
No. 1 is defy global warming in a way that creates jobs. We are doing new clean energy projects. For example, Swiss Re committed to spending $300 million for windmills and clean energy around the world. Two, fight poverty. Deutsche Bank has started a $100 million small-business development project in Africa. Third, we are working on religious reconciliation . . . and have a number of projects to stop human-rights abuses. For example, Vital Voices is a group that Hillary started that brings together women around the world. They are working on stopping human trafficking.

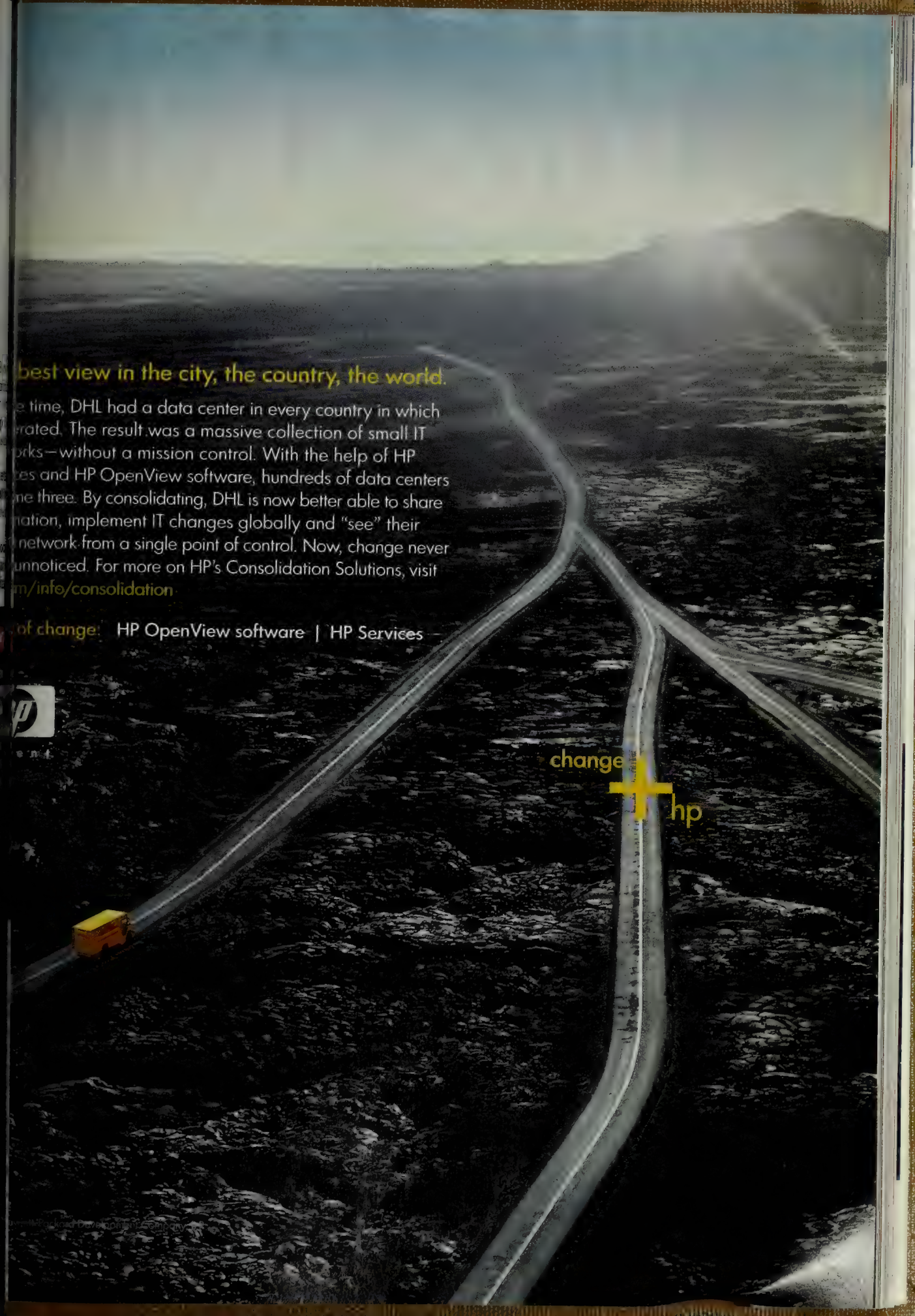
Energy has been a big issue for the initiative. What do we do about Americans' addiction to oil?
We should do what I tried but was unsuccessful in doing [as President]: Go back to raising mileage standards on vehicles. [Some] 70% of our oil usage is in transportation. We should make a major effort to use a biofuel to replace diesel no cars and trucks but boats. When I worked . . . on Katrina ran into a guy who runs his boats on biofuel. So start wit portation, then make an aggressive effort to develop cl technology, wind, and solar, and do a better job of usin

You have been a vigorous proponent of opening markets have any second thoughts about the rush to globalizatio
No, not in terms of whether on balance people are bett

Do you think the outcry against the CNOOC bid for Unoca the Dubai Ports deal and resistance within the European cross-border takeovers signal a reevaluation of globaliza
I didn't have a problem with CNOOC. I didn't see that tional security issue. I thought the port issue was differ Chinese oil proposal was seen by some as an isolated e cause the Chinese government owned the subsidi Dubai Ports proposal was different because there was on our national security. [Still,] we need to watch our because it has become a little more protectionist, and nately this country has gotten into a situation where we billion a day coming in from foreigners to keep the sh

If Senator Clinton wins the Presidency in 2008, what's y
I don't know if she will run, but my attitude is I would ever is asked for my country. The same as if I were President Bush. But I have no agenda and no desig happy working on my foundation.

Maria Bartiromo is the host of CNBC's Closing Bell.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Ideas Outside Shot

BY DON A. MOORE

SarbOx Doesn't Go Far Enoug

Whatever the verdict in the current trial of Enron Corp.'s two former to executives, key failures that cost investors and employees tens of billion dollars are all but sure to happen again. The calamitous scandals at En and many other companies were possible only because of breaches in a bulwark of our free-market system: auditor independence. Unfortunate

the Sarbanes-Oxley Act, Congress' response to the scandals, largely overlooks the conflicts of interest that represent the greatest threat to auditor objectivity. Only a radical reorganization of the current system will eliminate this risk.

As Philip Tetlock, Lloyd Tanlu, Max Bazerman, and I point out in a recent article in the *Academy of Management Review*, Sarbanes-Oxley, for all its reputation as a hard-hitting law, fails to correct a crucial accounting system weakness: the potential for what we call "moral seduction" of outside auditors.

This corruption remains likely for several reasons. Executives still have too much control over hiring and firing auditors, which discourages accountants from filing critical reports. SarbOx puts only minimal restrictions on auditors' taking jobs with their clients, a prospect that inclines accountants to curry favor with potential employers. And the law still lets auditors provide some types of nonaudit services, including SarbOx compliance work, despite longtime Securities & Exchange Commission concerns that such services increase auditors' likelihood of yielding to client pressures on auditing issues.

The principal reason SarbOx leaves the door open to moral seduction is that it assumes the most common threat to auditor independence is intentionally corrupt behavior. But psychological research on conflicts of interest demonstrates that the real threat to impartiality is unconscious bias, not unlike attachments and loyalties pervasive in life. In one experiment, auditors were asked to evaluate a fictional company's accounting practices, and those who were told that they had been hired for the task by the company itself were far more lenient than auditors who were told they had been retained by a firm doing business with that company.

To see the real-world consequences here, just look at Enron. Its auditor, Arthur Andersen, came to identify so strongly with the client that its judgment was compromised, and the demise of one led to the demise of the other.

SarbOx was supposed to change all that. Yet the law leaves in place strong incentives for auditors to please clients it mandates complex new rules that are supposed to m corporate books more credible. The one that has receiv most attention makes a company's chief executive and financial officers personally liable for inaccuracies in fi reporting. But while fear of lawsuits and prosecution n avert some intentional fraud at the top, it won't preven unconscious bias—or the skewed financial reports that from it. That's why we need to change the system, not search for smoking guns and lock up guilty individuals

Further rules are needed to counter auditors' natural bias in favor of their clients

Either of two alternatives would be superior to the p system. One would be a stiffer regulatory approach wh the government requires that auditing fir perform audit services solely; be retained fixed period without the chance of being r prohibit employees from taking jobs with clients; make independent assessments ir of just ratifying clients' accounting; and b by boards rather than company executive

The second solution, relying on market principles, would require companies to bu financial-statement insurance, meaning t underwriters would hire auditors and be hook for any blowups. Premiums that ins charged would publicly signal their confi in the accuracy of the financial reports, ju higher interest rates on a company's bon signal fears about its risk of default. This approach isn't too different from laws that force driver have auto insurance coverage that protects everyone el

Despite objections that such reforms would be too c is unlikely that either approach would greatly increase for the average audit. But the larger point is this: With independence, the outside auditor is redundant with a company's own internal accounting staff, and the bene having an auditor is of questionable value to begin wit Indeed, if it's not worth some cost to create independe need to question why we even have an auditing profes

Views expressed in Outside Shot are solely those of contributors.

Don A. Moore *is an associate professor at the Tepper Sch Business at Carnegie Mellon University.*

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THE WORLD'S MOST INNOVATIVE COMPANIES

p. 62

by Jena McGregor

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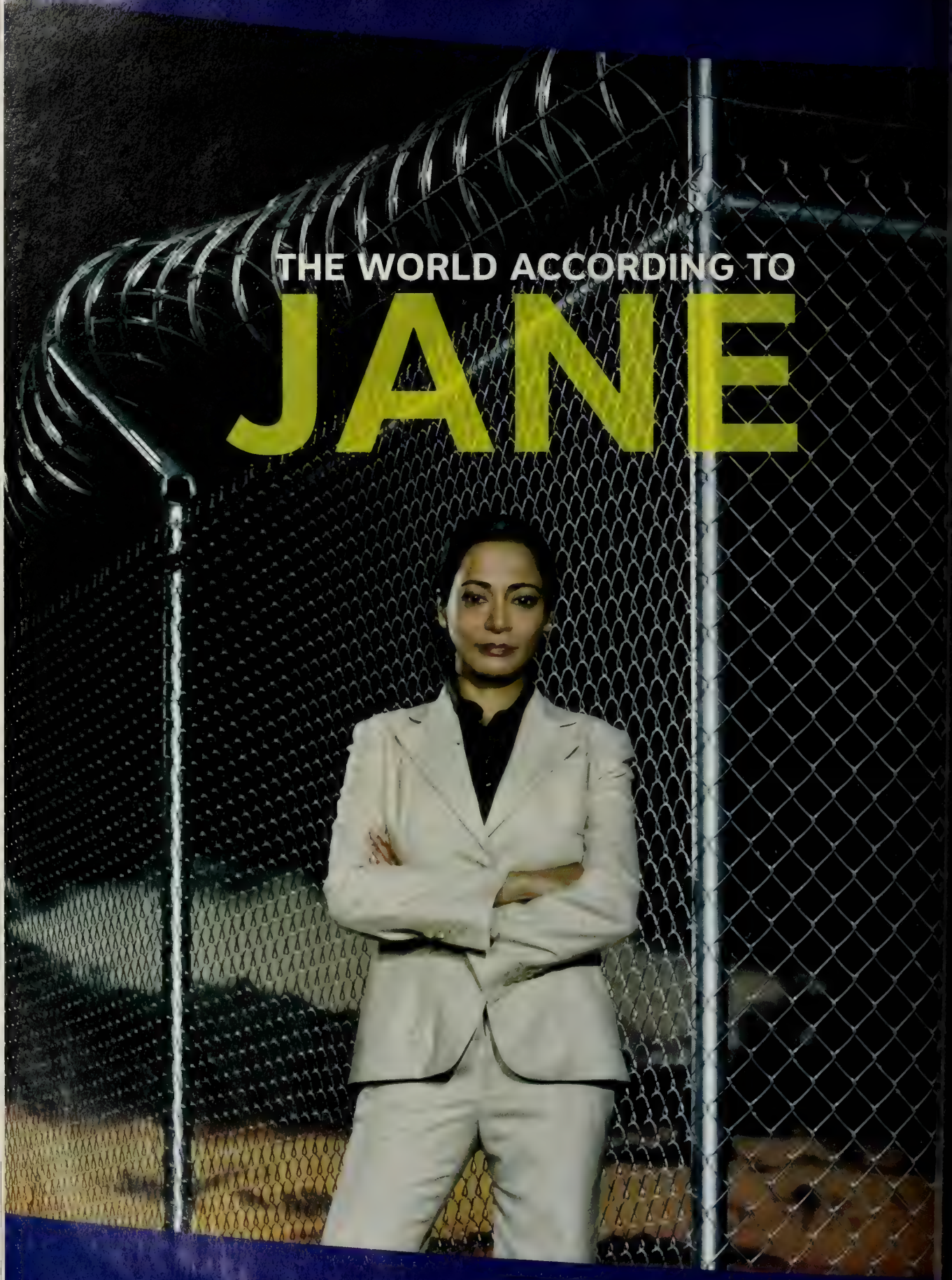

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April 24, 2006

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76 A Better Bottom Line
Companies that innovate have hig stock prices and bigger profit mar

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28 News You Need To Know
Skilling; trading on *BusinessWeek*; Vioxx; Disney; Burger King; and n

News: Analysis & Commentary

30 Trade: Advantage, China
Under WTO rules, America has a shot at forcing Beijing to level its playing field—or to do much else

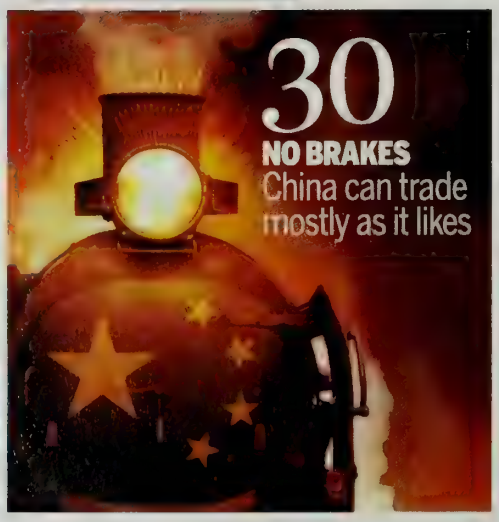
33 Commentary
Why China and America commun so poorly, and how they could do

34 Investors Short Bush
Defections could threaten GOP po

36 Your Ad Here—And Who Knows
How "adware" purveyors are hija legitimate Internet ads

62
SHAKE UP THAT THING
Which companies innovate best and why? We put the question to 1,000 senior managers in a global survey

88
FISH STORY
Artificial gills and news from the lab



30
NO BRAKES
China can trade mostly as it likes

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isers are starting to produce their
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ackDown Italian-Style
Wresting Entertainment has a hot
owth market among Italian boys

bal Business

ogle-Like Growth in Taiwan
Chou's high standards and a tie-in
licrosoft have smartphone maker
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Airbus Dogfight in China
race to catch up with Boeing
sn't apt to pay off

Global Coverage:
dditional insights into European
sian business, please go to
businessweek.com/globalbiz

e Corporation

y: Taking Heat
dor
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profits. Is
riation of its oil
next?

The Best Performers

iance

ore One for Cerberus
n Feinberg's fast-growing hedge
ot GMAC and KKR didn't. But it's
fraught with peril

d Flags at Mortgage Lenders
nquency rates rise, some
sive outfits are at risk

rkplace

Bankrupt, Then Go Overseas
lphi, Chapter 11 is but a
zation strategy—one that other
arts makers may copy if it works

al Affairs

derdog or Patent Troll?
com went from making software
g tech giants. Now founder
d Lang is going after Apple

90
WHEN I'M 54
Boomers are driving a market in rock 'n' roll memorabilia, but some items are no steeper than blue suede shoes

Science & Technology

78 Eyes Wide Open
Cephalon's careful marketing of its narcolepsy drug could serve as a manual for turning ideas into hit products

88 Developments to Watch
Artificial gills for underwater breathing; fat in your DNA; faces as passwords

Entrepreneurs

80 Gimme Shelter, and Make It Snappy
How NASCAR helped Allied boost sales of its low-cost warehouses and garages

Marketing

82 Winning Back Joe Corkscrew
Mouton Cadet is making over its famous Bordeaux to mimic more popular wines

83 The Chilean Connection
Wines from South America could bolster Rothschild's Bordeaux lineup

Executive Life

90 Rock 'n' Roll is Here to Sell
EBay has brought some prices down, but rare items are setting records

94 A Vegas Dino Never Knew
Luxe resorts far outside the Strip

96 Executive Life Plus
Weight-aware luggage; interactive travel guide; Hermès scarf for Katrina aid

Personal Finance

98 A Support Group for Swells
At Tiger 21, multimillionaires share investment advice and some life lessons

100 Cracking Open a Nest-Egg Planner
Vanguard's new online service is fast and easy to navigate

Columnists

22 Wildstrom: Technology & You
With better content and usable program guides, Internet TV could really take off

24 Fine: Media Centric
The much-maligned search ad may prove more versatile than you'd think

25 Cooper: Business Outlook
Bonds are becoming risky business again. That means tougher Fed choices
Jobs: Lots more help wanted

102 Marcial: Inside Wall Street

112 Jack and Suzy Welch: The Welch Way
If they're demanding yet fair-minded, tough bosses get more out of people

Ideas

108 Books
Dychtwald, Erickson, and Morison: *Workforce Crisis: How to Beat the Coming Shortage of Skills and Talent*

110 Outside Shot: Immigration
Why stimulating growth south of the border is the best immigration reform

Features

13 UpFront
18 Editor's Memo
20 Readers Report
20 Corrections & Clarifications
106 Figures of the Week
107 Index of Companies

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A Guide for the Perplexed Tech Buyer

Northwest Falcon's $5,000-plus Mach V customized gaming PC

It should be fun a easy, but it's not. Shopping for a ne PC or wireless ph presents a confus array of options that can cause feature fatigue e among the most knowledgeable buyers. Fear not our reviewers at BusinessWeek Online are here help. We've test six **high-end PCs** ranging in pric from $1,150 to $6,000 from sc well-known an not-so-well-kn manufacturers Dell, Gateway, Hewlett-Packard, Alienware, Falcon Northwe and VoodooPC among them—to find out if the old saw that " get what you pay for" holds true. How much computing pov can $6,000 buy and why would you want it? Ask hard-core gamers, who want tricked-out machines—all the better to frag their gaming buddies. We've also reviewed nine of the most sophisticated **smart wireless phones,** including the latest BlackBerry and the Treo 700w, as well as a few Samsung models. Finally, if you're simply in the market for a cheap cell phone that—get this—just **makes reliable calls,** we've taken a look at those, too, and can help you pick one that best meets your needs. You'll find reviews, slide shows, and more at **www.businessweek.com/go/06gadgets**

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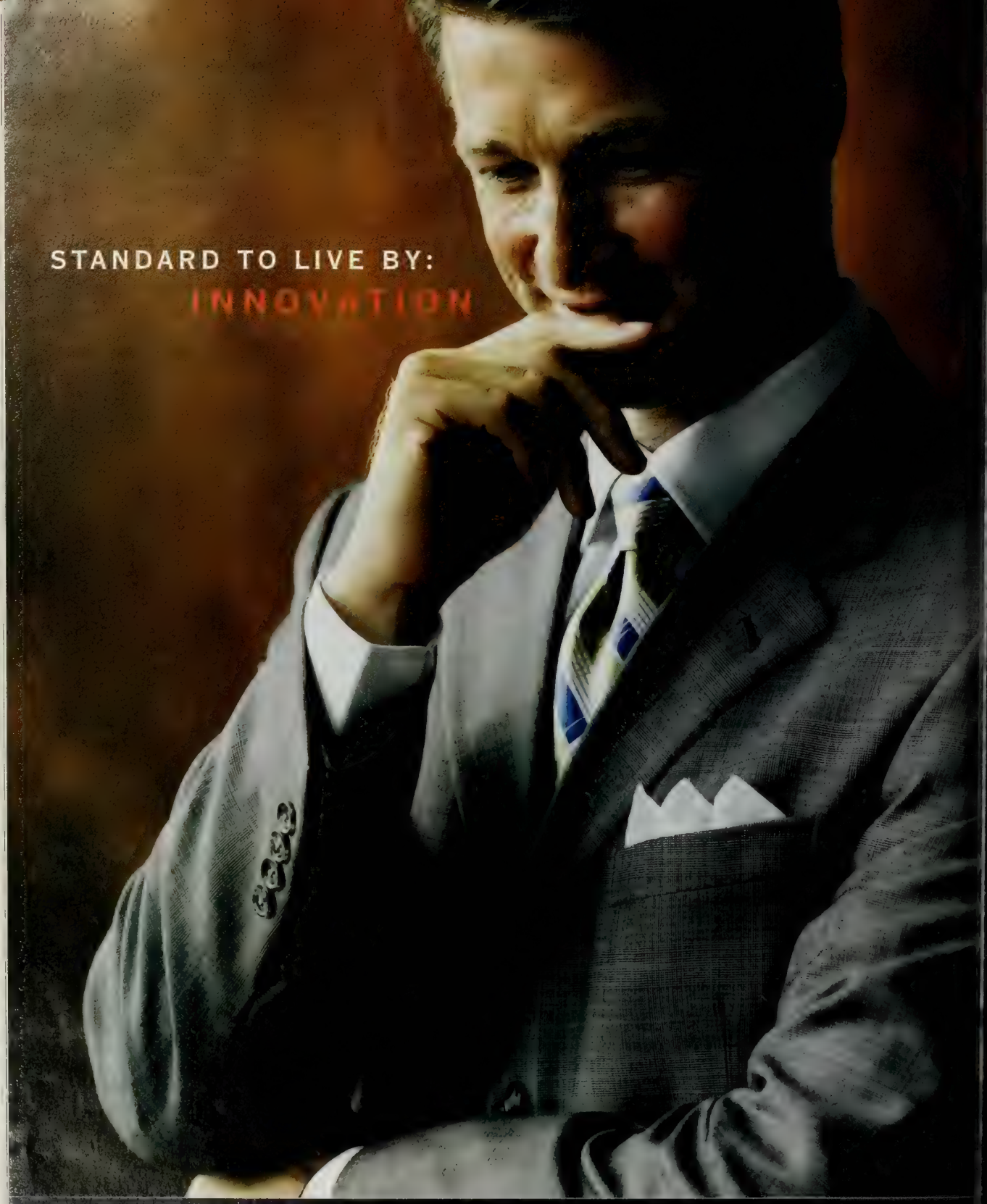

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UP Front

"Not in my wildest dreams, no. It's almost inconceivable now what happened."

–Enron ex-CEO Jeff Skilling testifying in his fraud and conspiracy trial as to whether he suspected Enron would go bankrupt months after he resigned in 2001

D BY DEBORAH STEAD

DIA MANIA

ING LOCAL STATIONS REAK

TRING of new deals to urrent TV shows over eb and video on d strains ties between ast networks and local es, Fox Television has d an agreement to ts roughly iliates to a slice of w Media usinessWeek urned. The ould be a model for rks like ABC, now in ith its affiliates over twork's plan to offer ext-day showings of f its popular shows on o site.

iate stations of ABC e other networks say evenues will suffer if s have the option of ng the shows elsewhere. Since affiliates help publicize the programs, they argue, they should share in New Media revenues the shows generate. The Fox pact allows stations to get a portion (the percentage is not clear) of the additional revenues for up to a year after they air a program. The deal was hammered out by Ed Wilson, president of Fox Television Networks, and Brian Brady, chairman of the Fox affiliates and president of Northwest Broadcasting, which owns stations in Oregon, New York, and Washington. Says Wade Hargrove, the lawyer for the affiliates: "This is a precedent-setting deal—for the affiliates to be able to participate in the near term in revenues from reruns shown on platforms other than the stations." A Fox network spokesman declined to comment. *–Tom Lowry*

FOX

GHANA James Burton (right) of Gap Sports

BRANDING BATTLES

Whose Gap Is It Anyway?

TAKING A YEAR off between secondary school and university is a treasured custom for young Brits. But the gap year, as it is called, has become a legal issue for **Gap Inc.** The San Francisco retailer is suing **Gap Sports Ltd.**, a British upstart that places gap-year students in volunteer coaching and other public-service jobs in developing countries. In a suit filed in London, Gap Inc. alleges trademark infringement, requests damages of $500,000 plus, and demands that Gap Sports stop using the word "gap" in its Internet domain names. "Our trademark is one of our most valuable assets," says company spokesman Greg Rossiter. "It's our obligation to protect our brand."

Gap Sports founder James Burton, 26, couldn't be reached. But Sarah Jeffery, the company's lawyer, argues that "gap year" is a common term in Britain and that other gap-year marketers such as **Gapwork, Gapyear,** and **Ski le Gap** use the word in their online names. The retailer, she says, is "trying to claim a monopoly on the word 'gap'" and is "sorely underestimating the intelligence of the general public if they think consumers are likely to confuse our client with Gap Inc." Gap Sports expects to place 400 young people in volunteer jobs this year, up from 200 last year. Do Burton and David, his younger brother, who helps run the business, shop at Gap, which targets their age group? Says Jeffery: "If they did, they don't anymore." *–Louise Lee*

THE BIG PICTURE

ON THE JOB American workers have upped their contribution to their companies' revenues and profits at a faster clip than their European counterparts. (They also take fewer sick days.)

	U.S.	EUROPE
se in profit per employee ear earlier	55%	14%
se in revenue per employee	12%	8%
ays taken per employee	5.5	10

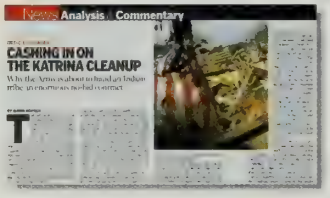
aterhouseCoopers Saratoga survey of 60 and European companies, 2004

UP Front

REWIND

A CLEANUP CONTRACT IS SCRUBBED

IT LOOKED as if the Mississippi Choctaw Indians had lined up a sweet deal: a $300 million no-bid federal contract for Hurricane Katrina cleanup in their home state. (The Choctaws gained notoriety as one of


Analysis Commentary
CASHING IN ON THE KATRINA CLEANUP

Jack Abramoff's biggest clients, having paid the since-convicted lobbyist and his partners about $27.6 million to sway Congress on gaming issues.)

Pressured by Mississippi politicians to replace the current out-of-state contractor with locals—and legally stalled by rival bidders' complaints—the **Army Corps of Engineers** planned to award a "bridge" contract to a Choctaw construction unit, **IKBI.** Under special rules, Native American businesses can land no-bid federal contracts of any size (BW-Apr. 10). But last week, the Army said the job instead would go to the nonminority Necaise **Brothers Construction**, based in Gulfport, Miss.

The new deal, now worth $150 million, is on hold due to another complaint by the current, Florida-based contractor, **Ashbritt.** But the Choctaws aren't entirely out of luck. IKBI is a candidate for a separate $25 million contract set aside for small or minority outfits. "We hope we've got a shot at something," IKBI President Josh Gamblin said.

–Dawn Kopecki

FASHION FAST-FORWARD

CHEAP-CHIC apparel has a new queen. Sal for Spanish retailer Inditex, best known for Zara shops, were up 21% in 2005, to $8.15 billion. That puts Zara ahead of longtime le H&M Hennes & Mauritz, which had sales c $7.87 billion. Using in-house design and tig controlled manufacture and distribution, Z can stock new trendy styles weekly. "They' built up an excitement around snapping up new clothes before they [sell out]," says Kr Miller, a Bain & Co. analyst. Fast-fashion sa which have grown twice as quickly as over clothing sales in Spain and Britain, accoun just 1% of the $181 billion U.S. clothing ma Plenty of room to grow. *– Rachel Ti*

BLOGSPOTTING

LEGAL EAGLES

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» **WHY READ IT** For edifying quips from employment litigators Lou Michels and Rod Satterwhite at McGuireWoods.

» **NOTABLE POST** "The Kansas Supreme Court joined...over 20 other states in recognizing that innocent victims of horseplay...may be entitled to workers' compensation.... The case involves a plaintiff who leaned back in her chair while waiting for a meeting to start. The chair, of course, had little wheels on the bottom. Suddenly, it was like the plaintiff was back in fourth grade—a colleague grabbed the chair, and the plaintiff hit the floor.... Who says work's no fun?"

DRAWN & QUARTERED

"I HAD TO DO SOMETHING—MY BONUS IS BEING TIED TO PERFORMANCE."

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UP Front

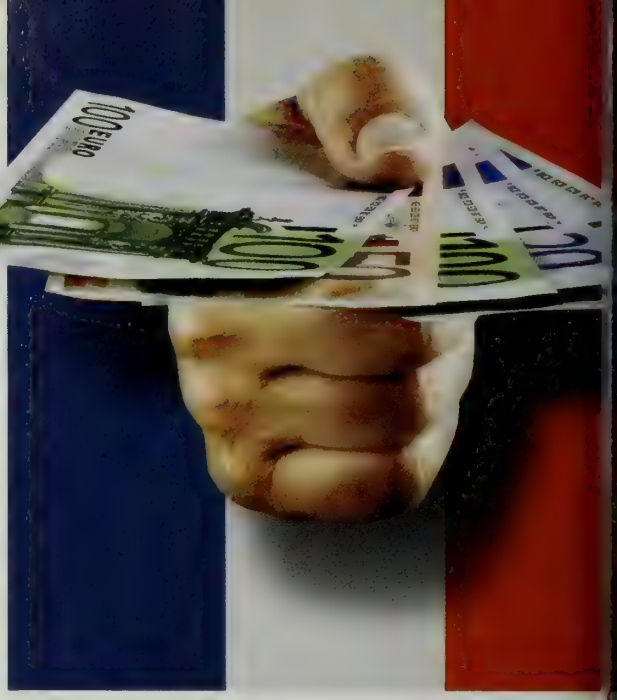
E-PORN STILL HAS NO FIXED ADDRESS

Plans to create dot-xxx Web domain were shelved late last month, and porn surfers weren't the only ones disappointed. European Union officials charge that American politics and puritanism were behind the decision by the U.S.-based Internet Corporation for Assigned Names & Numbers (ICANN) to postpone approval for a triple-x domain.

The delay, says Martin Selmayr, a spokesperson for the EU's Commission for Information Society & Media, "takes away from the credibility of the argument that the U.S. is in favor of a free Internet." ICANN was advised to take "adequate additional time" on the issue by the Commerce Dept., which oversees the organization, after conservative groups argued in a letter-writing campaign that a triple-X domain would foster more Web porn. To fight what it views as U.S. hegemony over the Web, the EU commission wants ICANN to report to an international body like the U.N. when its latest Memorandum of Understanding with Commerce expires in September. *–Burt Helm*

IMMIGRATION

FRANCE'S PLAN: PAY 'EM TO GO HOME



AS DEMONSTRATIONS intensify and legislation stalls in the U.S. over the status of illegal immigrants, France has been taking another tack. It's offering cash payments—the equivalent of about $2,400 per adult and $600 per child—to illegals who agree to return to their native countries. The government began to offer the payments last September but so far has found fewer than 200 takers. Now, law-and-order Interior Minister Nicolas Sarkozy is urging officials to cut the program's red tape to make participation easier, according to the French daily *Le Figaro*, which obtained a copy of an Interior Ministry memo sent to local officials. But critics say the payments are too low to entice many of France's estimated 400,000 illegals to say adieu.

Meanwhile, France is getting tougher on those who don't leave voluntarily. Since 2002, the number of illegals expelled annually from the country has doubled, to 20,000 last year. At the same time, Sarkozy is spearheading legislatio make it easier for well- educated, highly skille immigrants to enter th country. Sarkozy, the fr runner in the 2007 Fre presidential race, is himself the son of an immigrant. His father f communist Hungary ir 1949 and was granted refugee status in Franc *–Carol M*

LABOR NOTES

THE BOSS IS WATCHING—SO WATCH YOUR iPOD

TRYING TO TURN out productive workers as efficiently as possible, a few fast-food chains are using iPod video players to train new employees. **Pal's Sudden Service,** a regional chain with Tennessee and Virginia outlets, started iPod video training in its 20 restaurants in February. "We're looking to expedite the learning process through technology," says Pal's CEO Thom Crosby. **Chuck E. Cheese's**, the pizza-and-games chain, is a few months into testing the video iPods in one of its Dallas outlets.

Both programs, developed by **podTraining**, a Flower Mound (Tex.) startup, use short video clips to show new hires how to do their jobs. Unlike video or DVD-based training systems, the iPods can be updated quickly and cheaply by downloading new content. And the portability of the iPod allows training to be done on the job. New Pal's employees practice making the cha trademark Big Pal burg while watching a video process. Other videos ac customer service, ethics cashier operations.

TJ Schier, president a founder of podTraining he is developing more f food training videos for iPod, including troubleshooting segme produced with **Coca-Co** teach workers what to d when a soda machine breaks. He says retailer banks, and pharmaceut companies are now ask the company for iPod v to train clerks and salespeople. At Pal's, th iPod program has shav week and a half from n employee training time Crosby says, and has cr a cool factor that has gi boost to recruitment. *–Elizabeth*

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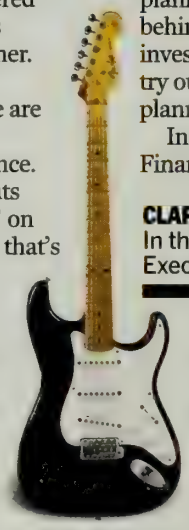
Your Money and Your Lif

WE HAVE LONG RECOGNIZED THAT, as *BusinessWeek* readers, you a as rigorous in managing your personal finances as you are guiding your business. We also know that you pursue you leisure activities with the same intensity that you apply to advising clients, running factories, and marketing your wares. For many years we've covered these myriad aspects of your lives under the Personal Business banner. Now, to delineate financial from lifestyle coverage more clearly, we are splitting PB into two sections: Executive Life and Personal Finance.

This week, Executive Life debuts with "Rock 'n' Roll is here to sell" on collecting rock memorabilia. And that's just a sample of the range of coverage we'll be offering. Our travel stories will find interesting new places to visit, or take a fresh look at some old favorites. Our auto reviewers will road-test new models and offer expert critiques. Our personal-tech writers will test cameras, computers, televisions, cell phones, and other gadgets from the vantage point of real users. And we're expanding our coverage of food, restaurants, spirits, and wine.

In Personal Finance we'll focus on all aspects of investing and managing your money, such as screening stocks, rating mutual funds, and interpreting financial statements. We'll also cover real estate investments, insurance, and estate-planning. This week we take you behind the scenes of an ultra-exclu investment/networking club. We al try out Vanguard's revamped finan planning service.

In both Executive Life and Perso Finance, we promise must-read ser journalism that guides you in yo personal decisio making.



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In this week's Executive Life

FOR THE COVER STORY, we have once again teamed up w Boston Consulting Group to rank the most innovative companies worldwide, those whose new products, creativi culture, and energetic management make them models. From these leaders we have distilled lessons for companies that to improve their game. The report continues on the Innovation & Desig channel at BusinessWeek.com.

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ReadersReport

ADDING UP THE BUSINESSWEEK 50

I BEGAN READING "The BusinessWeek 50" (Cover Story, Apr. 3) thinking: How wonderful that the U.S. economy is booming so. What growth! What opportunity! But by page 97, I was disheartened. Of the 50 companies recognized, only one was led by a female CEO. For this second-year MBA student, it was a reality check in how little headway my gender has made in the business world, and how far there is to go.

–Liz Gremse
Santa Monica, Calif.

THE BUSINESSWEEK 50 long-term earnings growth rates detailed in "The ranking" averaged over 13%, weighted by earnings. Granted, the list is supposed to capture *BusinessWeek*'s assessment of the top 10% of the S&P 500 universe, but only 3 of the 50 companies had long-term earnings growth rates less than 10%.

The BW50 list was composed of companies with an aggregate market value of $2.4 trillion, representing 20% of the total S&P 500. If one assumes that the long-term real growth rate of the U.S. economy is 3.5% and inflation really is 2.5% (yeah, no one believes the inflation figure but the government), then the aggregate long-term earnings growth rate of the S&P 500 would be 6%. (I won't mention that larger companies generally increase earnings more slowly than smaller companies.)

Given the above, the implied long-term earnings growth rate of the remaining 450 S&P 500 companies is 4.2%. Does *BusinessWeek* really believe that the BW50 companies will increase their earnings more than three times that of the remaining 450 companies over the long term? Just when Eliot Spitzer starts to clean up Wall Street research, *BusinessWeek* picks up the slack in the cheerleading section.

–Michael Fadil
Providence

I NOTICE WITH SOME dismay that missing completely from this year's 50 top performing companies are those that last year were Nos. 1, 3, 7, and 10. If performance is so fleeting, of what importance is such an annual listing?

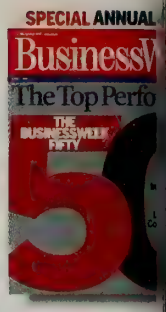
–Peter R. Lantos
Erdenheim, Pa.

HAMAS AND THE IRA: NO COMPARISON

IN "FOR CITI, 'No more excuses'" (Face Time, Apr. 3), Prince Alwaleed bin Tal Al-saud states that you can compare Hamas to the IRA in Ireland. Perhaps I missed it, but when did the IRA call for the elimination of Britain as a nation?

–Harold B. Reisman
Carlsbad, Calif.

> "Just when Eliot Spitzer starts to clean up Wall Street research, [you pick] up the slack in the cheerleading section."
>
> *–Michael Fadil*
> *Providence*



CORRECTIONS & CLARIFICATIONS

In "Mission: Precarious" (Entertainment, Apr. 17), we described private eye Anthony Pellicano as having been indicted for wiretapping personalities including Garry Shandling. This is incorrect. Pellicano was indicted for using a Los Angeles Police officer to illegally search the National Crime Information Center for information on Shandling in January, 1999.

In "Net movie mogul" (Voices of Innovation, Mar. 20), Mika Salmi discovered Nine Inch Nails in 1989, not 1998.

A BOON FOR THE SHAREHOLDERS OF ONE BIOTECH

WITHOUT COMMENTING on the premise of "Biotech's boon or bane?" (Finance, Apr. 10) that hedge funds are increasingly a source of capital for biotech companies, I strongly object to your characterization of ValueAct Capital's role at Chiron Corp. and my relationship with CEO Howard Pien. ValueAct Capital is a long-term investor with a track record of successful corporate governance. At Chiron, ValueAct Capital worked to defend all shareholders from a hostile takeover by the company's largest shareholder, Novartis. ValueAct Capital's position was publicly supported by Citibank Asset Management, the largest non-Novartis shareholder and a 20-year owner of the business, as well as independent corporate-governance watchdog Institutional Shareholder Services (ISS). As we stated many times in our letters to the Chiron board, Howard Pien's track record during our investment period has been one of success. We have tremendous respect for his accomplishments, but we strongly objected to his participation in a road show supporting vartis buyout at $45.

I would counter your assertio "Chiron clearly isn't enthused ab dealings with ValueAct" with the vation that Novartis ultimately inc its buyout price from $45 to $48, resulted in $335 million of addition ue for non-Novartis shareholders estimated $65 million more in va Chiron executives' and employees and stock options.

–G. Mason
I
ValueAct
San Fr

Editor's note: Novartis increased i out offer after *BusinessWeek* went to

POLITICIANS MISS THE OBVIOU WHEN IT COMES TO OIL ADDICT

SENATOR RICHARD G. Lugar ("ing outside the barrel," Outside Mar. 27) and President George W both miss the easiest and most ef way to help reduce America's ad to oil: Increase the mandated fuel my standards on cars and "light"

–Bruce J
Estes Par

How to reach *BusinessWee*

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BY STEPHEN H. WILDSTROM

Almost Ready for Prime Time

TV has been waiting for its big moment on the Internet since the days o fuzzy videos the size of postage stamps streamed over dial-up connectio Now network connections are fast enough to deliver video of reasonabl quality, and studios are releasing more content despite their continuing dread about piracy. The result: Real TV content is coming to the Net.

Mind you, most of the TV programming available for download or streaming is no threat to HBO or even FX. Disney announced on Apr. 10 that it would make popular ABC shows, including *Lost* and *Desperate Housewives,* available free on the Web, but they will be offered in relatively low-resolution streaming form. And when CBS streamed games from the recent NCAA men's basketball tournament, the results weren't ideal: The screen had a distressing tendency to go blank at critical moments. The rest of Web video content, both free and paid, comprises an assortment of programming targeted at niche audiences, such as sailing fans, and old network shows, mainly programs that aren't memorable enough to be candidates for syndication.

The most interesting new venture is AOL's In2TV (www.aol.com/in2TV), which offers free programming made up of old shows with up-to-date ads, from sitcoms such as *F Troop* and *Alice* to dramas such as *Maverick* and *Spenser: For Hire.* Episodes are streamed at up to 700 kilobits per second, which produces a slightly fuzzy full-screen picture. Most programs are also available as downloads at effectively full broadcast quality. In2TV requires the latest Windows Media Player software, so it only works on PCs.

THE NEW GOOGLE VIDEO STORE sells a variety of commercial TV content along with a mishmash of amateur video and assorted goodies found on the Web. Unfortunately, Google seems to think that since its interface is ideal for Web searches, it must be fine for everything else. The site is a pain to navigate, and the offerings are all over the map, with everything from current shows such as *CSI* to classics like *I Love Lucy,* all for $1.99 an episode.

Even some high-definition TV is starting to make it onto the Net. Internet video distributor Akimbo has struck a deal with cable and satellite channel HDNet to provide high-definition downloads to Windows XP Media Center PCs. The initial HDNet offerings consist mainly of *Bikini Destinations,* which is what you'd expect, but w gorgeous image quality. Yo for that. The shows cost $8 apiece, in addition to the $ month Akimbo subscriptio Akimbo aims to provide m substantial fare soon.

My guess is that both th ety of shows on the Net an quality of most of the video going to improve as studio more comfortable with onl distribution. Still, two othe things must happen for the line TV experience to appe more than just early adopt First, we need something li onscreen guides provided b ble and satellite systems. R now you have to check frag ed sources of Internet TV, s iTunes Music Store, Google Video, and In2TV, one by o learn each of their different faces. Second, viewers wan watch TV content, whether comes from cable, satellite, Internet, on a TV set, not a

Net TV is getting there. Here's what could make it really take off

Apple's newest Mac mini and some Media Center PC be connected easily to a TV or home theater, and their F Row and Media Center software is designed to be used remote from across the room. But most of the Internet offerings don't make use of this software. What's really needed: much simpler ways to find online content and easy-to-use appliances that let you download and displ those shows on a TV. ■

E-mail: techandyou@businesswe

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Rise of the Lowly Search Ad

When it comes to the pecking order of advertising, the search ad ranks slightly below "classified ad" and slightly above "poorly Xeroxed Herba flyer stapled to a telephone pole." ¶ But only slightly. In many cases, sea ads—those cryptic text come-ons that run around Google or Yahoo! sea results—embody the hucksterism associated with less savory ad forms.

(If you don't believe me, try Googling "hair loss.") Nevertheless, search is a defining media behavior of the here and now, and so the search ad itself occupies valuable real estate. This is why savvy big-name marketers are now tying search ads into more traditional campaigns. They're buying up highly trafficked keywords—like "Oscars," in the case of Coca-Cola—aiming to redirect searchers to sponsored sites. They're paying for keywords that have little to do with the product itself, like "platypus" and "possum" in the case of Honda, which is trying to lure Web surfers to a site promoting its Element truck. "The creative element of search rears its head," says Ron Belanger, senior director of global advertising strategies for Yahoo Search Marketing. The onscreen version of junk mail may prove a more versatile marketing tool than you'd think.

CRAB WALK Look for "crab," land in a Honda ad

SEARCH ADS work very simply. You buy the search terms; they appear in a specified sponsors-only area near the search results for that phrase; and you pay whenever a Web surfer clicks through to your site. But search ads' value still escapes many otherwise savvy media executives. In a public appearance last year, *Vanity Fair*'s Editor-in-Chief Graydon Carter noted that while he used Google often he never remembered the ads nearby. But recall is not what search ads are about. They're about enabling a more direct link to commerce than a TV or magazine ad. The pay-per-click model gives marketers an easy metric to calculate a price per lead. It also explains why demand drives up the cost of adjacencies to certain search words. The classic example is mesothelioma, a lung cancer caused by exposure to asbestos, which search ad executives say can cost more than $50 per click, inflated by law firms sniffing massive asbestos-related settlements.

By the same token, low-demand keywords cost less, so some search-term tack-ons provide bang for little buck. The current Element campaign features vehicle "talking" to sundry animals platypus, a possum, a burro, and a in cartoony spots. Honda's agency, Postaer & Associates, bought those keyword terms and uses search ad invitations to "see the platypus in Element." That link leads consum elementandfriends.com, which fe Element ads and a related game. also bought variants of "funny vi and "funny commercials," which Mike Margolin, RPA's vice-presid associate media director, are sea terms that have demographic pr compatible with likely Element buyers. In many cases, the searc terms cost just 10¢ or 15¢ per cli says, and drew about 40% of the Element's Web site traffic. "It se a little quirky, but the more you thought about it, the mo seemed to resonate well with the campaign," says Tom Peyton, Honda's senior manager of marketing.

For the Honda Ridgeline truck, which was advertise during the Super Bowl, RPA bought what Margolin ide as a "few thousand" search terms somehow related to t Super Bowl (as in "Super Bowl ad"). Those terms, he w in an e-mail, generated over 3.5 million online impressi from just Yahoo and Google on the day after the Super alone. Margolin suggests such approaches are only the beginning. "The search ad impression probably gets a l too easily overlooked," he writes. "I think we'll see mor research this year related to the value of the search ad t doesn't get clicked." Some aren't waiting for that resea The Drum Major Institute for Public Policy, a nonprofit tank, began placing its grades of New York legislators' records alongside search results whenever a New York legislator is Googled. Now, could that work with an He flyer? Didn't think so. ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

AMES C. COOPER

onds Are Becoming isky Business Again

t means higher mortgage rates and tougher policy choices at the Fed

U.S. ECONOMY The bond market is in the middle of a nasty sell-off, l there may be more carnage to come. Since Feb. 22, bond prices e plunged, pushing up 10-year Treasury yields from just over 4.5% ust shy of 5%, the highest level since June, 2002. The latest upsurge e following news that the March labor markets, as well as the

my, retained a surprising amount of momentum at d of the first quarter. The report raised doubts that onomy was slowing enough to relieve inflation es at the Federal Reserve.

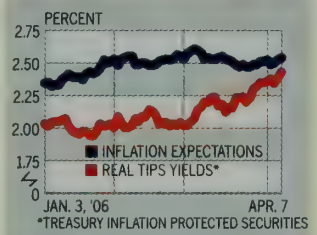
re important, fear is creeping back into the bond t. Until recently bond players shrank from ng—not strong economic growth, not energy-driven on, not even the Fed's hikes in short-term rates g more than 3 percentage points heading into In the past a set of factors like that would have bond investors run for cover. They would have nded much higher yields to take on the greater risk ding a fixed-income security for such a long period. ime long-term rates stayed unusually low, pting former Fed Chairman Alan Greenspan to dub enomenon a "conundrum."

w the mystery is starting to clear up. Bond investors that there is more risk in holding bonds than they reviously thought. Their unusually low assessment in recent years has been a key factor holding bond down. The question has been whether that ease in erceptions signified a lasting or temporary change way investors view the market. The recent sell-off sts that at least some of the shift was temporary. If ors are rethinking bonds' riskiness, then yields travel even higher in coming months.

e bond market's adjustment also raises the stakes on rate decisions by the Fed, since it could have icant implications for the outlook. In particular, r yields will lift mortgage rates further at a delicate or housing (page 50). The average 30-year fixed gage rate is already up to 6.5%, the highest in almost ears, and housing is weakening. In that sense, r bond yields may help slow the economy, thereby ing the need for the Fed to hike short-term rates.

NEW FEAR FACTOR in the bond market is not just nance that higher inflation down the road could eat he return on bonds. In fact, in recent weeks ures of inflation expectations have not moved up nuch. Most of the increase in bond yields has been d by higher real yields, which represent the non- onary costs investors perceive in locking up their money over a given period of time. That distinction is important, since it was a lower assessment of risk that had helped to push down real bond yields—and thus overall yields—during the year or so after the Fed began raising short-term rates. The rebound in real yields implies that some of the earlier downshift in risk perceptions is reversing.

RISING REAL RATES ARE LIFTING BOND YIELDS



*TREASURY INFLATION PROTECTED SECURITIES
Data: Federal Reserve, Global Insight Inc., *BW*

A comparison of 10-year yields on Treasuries and 10-year Treasury Inflation Protected Securities (TIPS) illustrates what's happening (chart). First of all, note that the market yield on a regular Treasury note comprises both a real yield and an expected rate of inflation. The yield on the TIPS, however, is a real one that investors earn apart from the premium they get if inflation rises. One way to gauge inflation expectations, then, is to look at the difference between the regular market yield and the TIPS yield. This exercise shows that more than two-thirds of the increase in the 10-year yield since Jan. 18 reflects a rise in the real yield. Only a third is caused by higher expected inflation.

THE ANALYSIS SUGGESTS that investors are reevaluating risks other than those for inflation. For one thing, Fed policy is much more uncertain. Until recently the Fed clearly signaled to the markets that it would raise its target rate in a series of measured hikes. Now, Fed decisions will turn almost totally on what the ups and downs in the data say about the strength of the economy and inflation, a fact that will also make the market more volatile in response to economic reports and other news.

New risks also are emerging from changing global conditions. Prospects for stronger growth and tighter monetary policy overseas are sopping up excess global liquidity, which had helped to keep bond yields low. These new global influences also put the dollar at risk.

Less liquidity and more attractive investment opportunities outside the U.S. could make it trickier for the U.S. to finance its huge current account deficit at today's level of the dollar.

If the bond market's evaluation of risk in the credit markets has, in fact, been excessively low, that would have implications for Fed policy. Financial conditions may well have been too stimulative over the past couple of years, implying that a greater degree of Fed policy tightening might be needed. Fed Chairman Ben S. Bernanke alluded to that possibility in his Mar. 20 speech on bond yields.

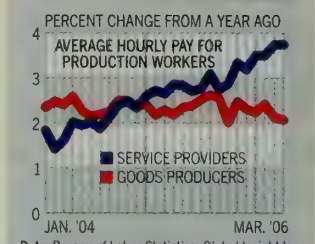
Already, the financial markets are anticipating that the Fed will lift its target rate to 5% at its May 10 meeting. The futures markets are beginning to bet on yet another hike after that. A few months ago only a scant number of market players expected the rate to go that high.

BUT IF THE ECONOMY CONTINUES to percolate partly because of past highly stimulative financial conditions, the Fed may have no choice. Its key concern now is high "resource utilization," meaning strong demand is putting pressure on labor markets and production facilities that could generate inflation. By those lights, the Fed saw no comfort in the the March employment report.

Labor markets continued to tighten last month as payrolls increased by 211,000 workers and the jobless rate fell back to 4.7%, matching the January rate as the lowest level since July, 2001. Earlier this year the Fed predicted that the unemployment rate would end the year in the range of 4.75% to 5%. That now seems unlikel

An average pace of about 175,000 jobs per month the past year has caused the unemployment rate to c by 0.4 percentage points. If that rate of payroll gains continues, the jobless rate would end up close to 4.4 That level would most likely fuel wage growth in exc productivity gains a threaten to lift inflat That's especially tru the service industrie which employ 80% private-sector work The service sector h accounted for all of recent acceleration i wage growth (chart

WHERE WAGE PRESSURE IS BUILDING



Data: Bureau of Labor Statistics, Global Insight Inc.

One worrisome implication of any p underevaluation of by the bond market to do with housing. Over the past couple of years, mortgage rates, which track the movements in 10-y Treasury yields, might well have been lower than th otherwise would have been if Treasury yields had b higher. Low rates may have helped to pump up hou demand. The higher rates go, the greater the dange big correction in housing activity and home prices.

As the bond market's new respect for the risks in outlook push up long-term rates, the Fed will have to a fine line as it decides how high to lift short-term rat

EMPLOYMENT

Even More Help Wanted

THE FINANCIAL markets were caught off guard by the strength of the March employment report. Wall Street, however, should expect more of the same in the coming months as businesses' need for additional workers keeps growing.

Besides the highly watched *Employment Situation* figures, the Bureau of Labor Statistics publishes another report on the market called the *Job Openings & Labor Turnover Survey* (JOLTS). The former shows only net hiring. The latter documents the gross hirings and separations that comprise net hiring. The latest JOLTS data, released on Apr. 11, provide a better view of the demand for labor by showing the number of job openings at businesses.

THE HIRING LINE STARTS HERE

JOB OPENINGS RATE*

	FEBRUARY 2005	FEBRUARY 2006
CONSTRUCTION	1.7%	1.9%
MANUFACTURING	1.8	2.3
TRADE, TRANSPORT UTILITIES	2.4	2.6
BUSINESS SERVICES	3.5	4.1
EDUCATION & HEALTH	3.4	3.5
LEISURE & HOSPITALITY	3.2	4.0

*JOB OPENINGS AS A PERCENT OF EMPLOYMENT PLUS OPENINGS

Data. Bureau of Labor Statistics, *BusinessWeek*

In February (the JOLTS data are a month behind their more popular cousin) the number of private-sector openings climbed to 3.59 million. That's up nearly 16% from a year ago. What's more, the January tally was revised up to 3.53 million, from an originally reported 3.49 million.

Demand is rising most in the service sector, where openings in business, education, health, leisure, and hospitality have increased by 268,000 in the past year. Manufacturing openings are also up.

While the March jobs data showed a drop in factory payrolls, the weakness has been in nondurable-goods industries such as textiles and apparel, which cut production jobs in the past six months. Durable-goods produc including computer and machi makers, added 111,000 producti workers over the same period.

Other signs of tightening job markets: Layoffs and discharge down 17% from a year ago, and posted a sharp decline in Febru The number of workers who ar leaving their positions voluntar is creeping higher too, albeit in and starts. It appears that comp are winding down cost-cutting moves, while employees sense t better opportunities can be had other employers.

Hiring trends should remain strong with economists lifting t 2006 economic growth estimat the labor markets tighten furth JOLTS data will help track the strength of demand for workers

–By James Mehring in Ne

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Skilling's Story Finally, the **Enron** trial moment everyone has been waiting for. On Apr. 10 **ex-CEO Jeffrey Skilling** (above left) took the stand, saying "my life is on the line" and denying all 28 charges of conspiracy, fraud, and insider trading. In perhaps the most critical testimony so far for the defense, Skilling said he never saw the "Global Galactic" memo, which detailed deals between the company and former **CFO Andrew Fastow.** The government claims Skilling knew his lieutenant was secretly guaranteed a return and that the sole point of the partnerships was to help Enron hide its debt and boost its profits illegally.

Skilling also said he thought the company was in great shape when he quit in August, 2001, after just six months as CEO, attributing the exit to his being "emotionally tired" and not having spent enough time with his family. And he claimed no recall of his attempt to unload 200,000 shares in September, 2001, weeks before the company went under. Prosecutors may get their shot at him on Apr. 17.

Immigration Imbroglio As hundreds of thousands of pro-immigrant marchers chanted "Today we march, tomorrow we vote," the White House and GOP leaders scrambled to salvage legislation that collapsed in the Senate on Apr. 7. A compromise that would have created a new guest-worker program and a path to citizenship for illegal workers failed after coming up short of the votes needed to choke off a filibuster. Business lobbyists hope **Senators John McCain** (R-Ariz.) and **Edward Kennedy** (D-Mass.) can broker a new deal that would make fewer immigrants eligible for legalization but protect the guest-worker plan.

See "The Best Immigration Reform," page 110

Vioxx Pain Gets Worse The jury sure didn't buy **Merck** was selling. On Apr. 11 the drugmaker got wha with $9 million in punitive damages—on top of $4.5 lion in compensatory damages—in a closely wat Vioxx trial. The case involved a 77-year-old man who heart attack after taking the painkiller. Merck plans t peal. The decision sharply raises the stakes for the co ny: Nearly 10,000 Vioxx lawsuits have already been fi

ONLINE *See "Why Merck remains unset*
www.businessweek.com/g

Disney's Latest Download Magic They'll need p of pixie dust to make this one fly. On Apr. 10, the M House said it will begin testing a setup that allows p to download from **ABC.com** the same shows that D provides to cable companies and ABC affiliates. The month experiment will include such hot programs as Cable outfits and the affiliates are grumbling loudly.

See "Giving local TV stations a break," page 13
ONLINE *"Disney's Internet adven*
www.businessweek.com/g

NASDAQ Isn't Giving Up His $4.2 billion offer t the **London Stock Exchange** got the cold shoulder NASDAQ **CEO Robert Greifeld** still covets those foreig ings. Greifeld on Apr. 11 disclosed that NASDAQ paid million for just under 15% of the LSE's stock to becom bourse's biggest shareholder. Observers say he may b ing to thwart a tie-up between the LSE and **Euron** Paris-based exchange, or orchestrate a three-way dea

ONLINE *See "NASDAQ takes a slice of the*
www.businessweek.com/g

Having It His Way The revolving door at **Burger Ki** swung again—at the worst possible time. After less two years on the job, the chain's fired-up CEO, **Greg B man,** announced on Apr. 7 that he was departing to be a private consultant. It's the 11th time since 1989 th occupant of the corner table has changed. Burger Kin quick to anoint **John Chidsey,** its 43-year-old presider chief financial officer, as Brenneman's successor, b exit comes just as the company is planning to hit th to whet appetites for its upcoming initial public offe which is already shaping up to be a hard sell.

See "Where's the beef?" (BW—Apr. 10
ONLINE *"Burger King's appetite for*
www.businessweek.com/

Loss of Face in France The good news: France is *quille* again after **President Jacques Chirac** yanked a you ployment law that touched off two months of angry p The bad news: The crisis, which humiliated Chira **Prime Minister Dominique de Villepin,** has killed any cha major economic reform before the 2007 presidentia tions, which is worrisome given that growth languish low 2% and unemployment is stuck near 10%.

ONLINE *See "France sacks youth labo*
www.businessweek.com/

:onville National Bank? To **Wal-Mart Stores,** it's t tiny credit-card processing fees. To rivals, it's about a hange in American banking. The two sides testified e the **FDIC** on Apr. 10-11 about the retail behemoth's cation for a charter to create an industrial loan corpo- ı—a type of bank. Wal-Mart pledged it would not storefronts to take consumer deposits. Unions and unity banks aren't buying that line and protested to ds. Another hearing will be held later this month.

net Up for Grabs With returns from pharma look- ickly, executives and investors in health care figure nted medical products might be a smarter bet. Bio- vill now test that notion. The maker of artificial joints med on Apr. 6 that it was exploring a sale, less than veeks after its co-founder and sole CEO, **Dane Miller,** enly quit. The last implant company on the block did- badly: **Guidant,** which makes stents and pacemakers, to **Boston Scientific** for $25 billion after a bidding war **Johnson & Johnson**. Analysts think Biomet would pull east $10 billion.

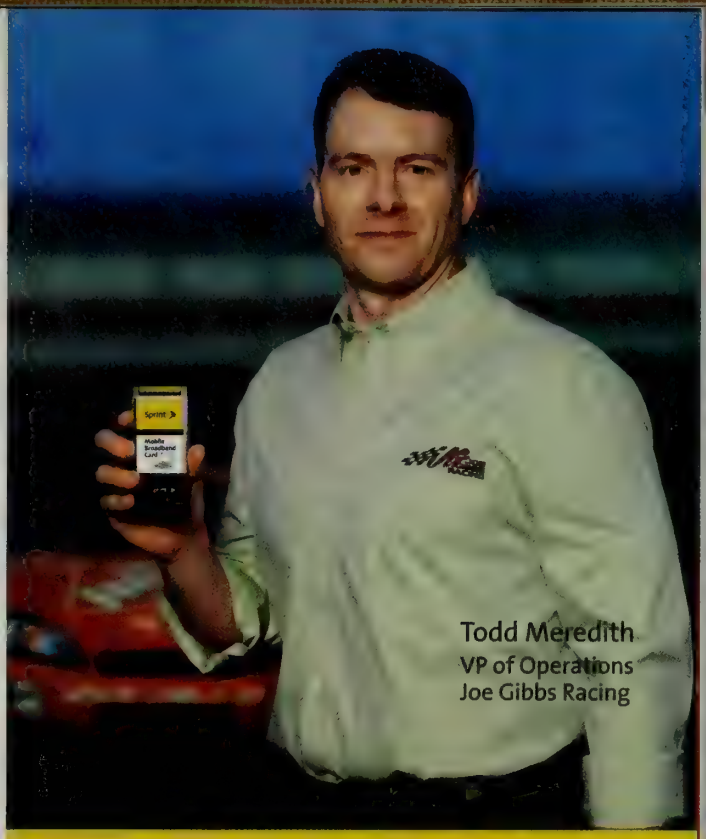
nline Safety Cop **MySpace.com** is trying to make rner of cyberspace less perilous. The fast-growing so- etwork said on Apr. 11 that it's hiring former federal cutor **Hemanshu Nigam** to be its first chief security offi- hat came a day after the site, along with other **News** Web sites and TV channels, announced a campaign of c-service ads promoting online safety. The moves ppease parents, schools, and officials who fret that ace makes it easy for sexual predators to target kids.

ONLINE *See "From MySpace to Safer Space," www.businessweek.com/go/tbw*

Criminal Case of the Week

Apr. 11 the **U.S. Attorney for the Southern District of New , Michael Garcia,** unveiled charges against three men allegedly got an early look at *BusinessWeek* by infil- ng a Wisconsin plant where the magazine is printed. three then allegedly traded stocks mentioned in the **e Wall Street** column. No *BusinessWeek* employees e involved. The **Securities & Exchange Commission** si- taneously brought a case alleging that the three—one **rrill Lynch** analyst—plus a global ring of 10 other con- ators, profited to the tune of more than $6 million by obtaining advance word on mergers. The in- sider-trading case is one of the most far- reaching in years. A retired seamstress in Croatia netted $2 million, the feds say. People have been prosecuted sever- al times since the late 1980s for trading on early access to *Business- Week*. A spokeswoman for the mag- azine's publisher, **The McGraw-Hill Companies,** says it has "taken sig- nificant steps to assure the integrity and pri- vacy of our stories."

MICHAEL GARCIA



Todd Meredith
VP of Operations
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GLOBAL COMMERCE

THE RUNAWAY TRADE GIANT

Piracy, currency valuation, industry subsidies. As its impact on the U.S. economy expands, China is also growing less vulnerable to American pressure on key issues. BY PETE ENGARDIO AND CATHERINE YANG

NUCOR CHIEF EXECUtive Daniel R. DiMicco sees a train wreck coming. True, Charlotte (N.C.)-based Nucor Corp., America's top steelmaker, had a banner year in 2005. But China now churns out more steel than the U.S., Japan, and Europe combined. Despite its own voracious demand, China has become a net steel exporter. More mills are in the pipeline that DiMicco complains are "massively subsidized" by interest-free loans, an undervalued currency, and export tax breaks. "If China decides to export significant amounts of steel," he warns, "there will be no such thing as competition."

DiMicco would love to see the U.S. file a complaint with the World Trade Organization to block a flood of Chinese imports. Trouble is, it's not clear that China's help to steel producers violates WTO rules. Besides, Washington does not want to bring cases it is unlikely to win. How about getting the Feds to file an anti-dumping suit in U.S. court? To succeed, Nucor would have to prove it was already damaged by cheap Chinese imports.

DiMicco's angst highlights a dilemma for Washington: No one quite knows what to do about a China that is growing into a trade giant but in many ways still plays by its own rules. True, China has liberalized greatly since entering the WTO in 2001. And it came bearing gifts on the eve of President Hu Jintao's trip to Washington. China has agreed to import U.S. beef and medical devices, load all PCs sold in the mainland with legal software, and buy $16.2 billion worth of Boeing jets, Motorola networking gear, and other goods. Another cause for cheer: America's February trade deficit with China shrank by 22.7% to its lowest monthly level in

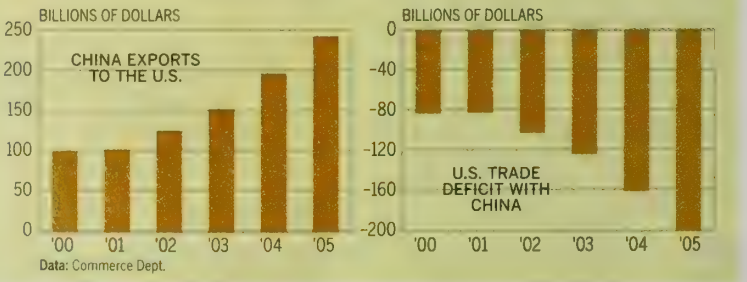
The moves, declared Chinese Vi mier Wu Yi, show Beijing's intent the trade gap and "observe the s equality, mutual benefit, and win-w

Yet worried execs like DiMicco signs of progress on the really big They include China's refusal to cantly revalue its currency, its we forcement of rampant piracy, and i tinued use of cheap credit, subsidi nontariff barriers to boost favored tries and companies. Besides bein aggressive in bringing antidumpin and WTO cases when China viola rules, U.S. officials say it's time for to go beyond the agreements it m 2001 and basically up. "We need a mo anced relationship U.S. Trade Represe Rob Portman, "ba the fact that Chi mature trading and a full-fledge member."

Balancing the r ship, though, takes clout the U.S. m have. The U.S. lost ity to impose un sanctions once joined the WTO.

CHINA-U.S. TRADE

Since China joined WTO in late 2001, trade with the U.S. has surged. So has the U.S. trade deficit.



Data: Commerce Dept.

IN THIS SECTION:

Why Bush's stock is falling with investors

36 Is your Internet ad getting hijacked?

38 TiVo this: Advertiser-produced TV shows

40 American wrestling's Roman holiday

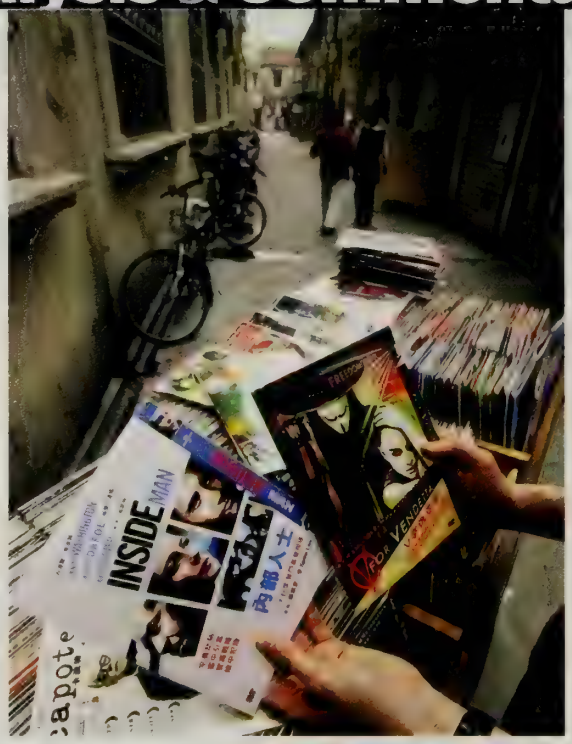
America hauled China to Geneva on issues like currency, intellectual property rights, and industry policies, its chances of winning under WTO rules are slight.

U.S. efforts to get China to beef up enforcement of intellectual-property-rights laws are a case in point. For more than a decade, Washington has demanded that Beijing halt the piracy of software, music CDs, and movies. China's laws are fine, and it can crack down when it wants: Witness the scarcity of knockoffs of the mascot dolls for the Beijing Olympics.

But due to weak enforcement, trade groups claim U.S. software, entertainment, and publishing companies lose billions in China due to illegal copies. While Beijing announced a 14-point plan on Apr. 11 to crack down on pirates, skeptics say the U.S. shouldn't back off until it sees results. Says Dan Glickman, CEO of the Motion Picture Assn., which leads Hollywood's antipiracy fight: "On these issues where China really has not responded, I think the best leverage is the WTO."

Is it? Even if the U.S. does file a case alleging inadequate enforcement, there's no guarantee it will win. That's because the WTO lacks clear standards defining adequate progress toward enforcement, says China trade expert Nicholas R. Lardy of Washington's Institute for International Economics: "The elephant in the room nobody wants to talk about is that we don't have much leverage." If a suit fails, Beijing could ease the pressure on pirates. "To bring a case and lose it is detrimental," Portman says.

Another problem, U.S. trade officials complain, is that many U.S. software companies have been unwilling to gather



SHANGHAI PIRATES The film industry estimates 90% of DVDs sold in C are illegal copies

and supply the hard needed to mount a succ case. "Our bigger cha isn't the law," says on cial. "It's getting the ev you need from com who don't want to be s cooperating with the government." Besides ing retaliation against mainland operations, tives aren't sure a succ WTO ruling will solve thing, given China's rule of law. "Even if yo would it really chang way business is done provincial level, or c the business environm asks Heather Clark, as Asia vice-president of Pharmac Research & Manufacturers of Ame

The U.S. has been just as stymie efforts to force a revaluation of the American manufacturers claim th is undervalued by as much as 40%, mainland exports a huge price ed response to Washington pressure, last year finally let the yuan flu slightly, but it hasn't gained eno make a big difference. A coalition manufacturers and unions petition USTR in 2005 to bring a WTO case ing China with manipulating its cu to boost exports. The USTR refer issue to the U.S. Treasury Dept. soon issue a report on the topic t gress, which could impose sanctio

Yet Treasury is unlikely to brand a manipulator. For one, many U.S panies that produce in the mainlan efit from a cheap yuan. And if the U posed penalties, it may be on thin the WTO. The trade body does n hibit managed currencies. And China has a huge trade surplus w U.S., overall it imports more than ports to the rest of the world. So ington won't get much backing showdown with Beijing. In real Treasury can do is beg Beijing to c

Good luck getting China Inc. to its policy of boosting strategic indu too. Perks like tax holidays, ta

Little Leverage

China has met most of its easier market-access commitments to the World Trade Organization. But forcing Beijing to address some of the big grievances that mark its trade with the U.S. will be tough.

INTELLECTUAL PROPERTY

PROBLEM China has pledged to crack down for years. But because of weak enforcement, U.S. software, music, and film companies claim $2 billion in lost sales each year in China due to piracy.

REMEDY The U.S. could file a complaint with the WTO claiming Beijing is not doing enough to enforce its laws. But it may not win because the WTO lacks clear standards for defining lack of compliance.

SUBSIDIES

PROBLEM Chinese producers of everything from steel and chemicals to chips and networking gear benefit from cheap or free loans, R&D subsidies, free land, tax holidays, and other advantages.

REMEDY Many of these subsidies don't violate WTO rules. And even if they give the Chinese an unfair advantage, the lack of government and company transparency makes the subsidies hard to document.

CURRENCY

PROBLEM Beijing keeps the yuan tightly linked to the U.S. dollar. Critics claim that leaves the currency undervalued by up to 40%, giving mainland exporters a big price advantage.

REMEDY The U.S. could file a WTO case alleging that China is manipulating its currency. But that would be hard to prove. The U.S. and IMF could declare China a manipulator, but they lack enforcement power.

For more stories on China, go to: www.businessweek.cc /asia

, low-cost land, and government rch and development subsidies necessarily violate WTO rules. help is proper, contends Wang , director of Beijing University's r for International Political Econ- For 20 years, China has given breaks to lure multinationals, n now dominate markets for cars, hones, and other goods. "Keep in that the growth we've seen has mainly driven by foreign-invested anies," Yang says, "while domestic anies have suffered a lot." Besides, dies that could be deemed unfair practices, such as free loans to or paper mills that export, are dif- to document due to weak govern- and company disclosure.

grieved companies can always file umping suits in the U.S. against

PIC MASCOT
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specific Chinese manufacturers that export at below-market s. The U.S. slaps punitive duties on ese imports in dozens of cases each But the litigation is time-consum- nd expensive, especially for small companies. "We've considered a ing suit, but a lot of our members have the money and time," says nasing Manager Zachary J. Mottl of s (Ill.)-based Atlas Tool & Die s. Mottl is a director of a U.S. asso- n of small manufacturers: Its bership has dropped from 1,600 to in six years as many succumbed to -cheap Chinese imports. "By the they get a remedy, they already d be bankrupt."

hat can be done to achieve radical ge? "You will not litigate a country hanging its more important prin- s on how to run its economy," says S. trade official. Washington can Beijing to the bargaining table WTO threats, but progress will be China the heavyweight will set the for some time to come. ■

–With Dexter Roberts in Beijing, Nanette Byrnes in New York, and Michael Arndt in Chicago

COMMENTARY

BY ROBERT LAWRENCE KUHN

A Problem of Perception

Why China and the U.S. aren't on the same page

CHINESE PRESIDENT Hu Jintao arrives in Seattle next week for his first state visit to the U.S. During meetings with the likes of William H. Gates III, Yale University students, and finally President George W. Bush, there will be plenty of talking. Given the huge geopolitical and economic stakes riding on that dialogue, it's appropriate to ask: Why do China and America have such difficulty communicating?

Sure, the two nations are half a world apart, geographically, historically, and politically. But the cause of their at times cacophonous discourse could lie in something less obvious: the strikingly different academic training of their political leaders.

The majority of American senators and congressmen were schooled as lawyers. But each of China's senior leaders—all nine members of the Politburo's Standing Committee—was trained as an engineer: President Hu in hydropower, Premier Wen Jiabao in geological structure, for instance. Perhaps the difficulties between China and the U.S. lie less with dissimilar languages, cultures, and histories, and more with the divergent ways of thinking between lawyers and engineers.

Hint: China's leaders are trained engineers. America's are lawyers

This is no small difference. Engineers strive for "better," while lawyers prepare for the worst. Failing to appreciate the implications of these different approaches (and the relating styles they engender) can lead to missed signals.

Such miscommunication occurred when a U.S. plane accidentally bombed the Chinese embassy in Belgrade, Yugoslavia in 1999. When the Chinese government bused students from college campuses across Beijing to the U.S. Embassy to protest, American politicians assumed that Chinese leaders orchestrated the demonstrations to whip up nationalistic fervor. (To lawyers, the evidence was prima facie.) In truth, the Chinese leaders—the engineers—worried that if protesting students were allowed to march through the city, their ranks would swell with workers and ordinary citizens, creating an even larger, less manageable problem. So busing them contained, rather than exacerbated, the volatile situation.

Another dichotomy: More than 90% of Chinese, including professionals often critical of their government, saw the bombing as deliberate. But most Americans believed the bombing had been, as U.S. officials claimed, an accident due to the use of "old maps."

Why such disparity? The Chinese have an idealized picture of the U.S. as so technologically advanced that it would have been impossible for it to make such a stupid mistake. Americans, on the other hand, are quite used to their government's stupid mistakes.

More worrisome, most Americans perceive China as an economic predator concerned solely about its own welfare. Beijing does not deny its policies benefit its own people, as any legitimate government's would. But it asserts that in a global economy, China's stability and development are essential for world peace and prosperity. Disturb the former, it warns, and you disrupt the latter. Given that consequence, it's time the lawyers and engineers began communicating better.

Robert Lawrence Kuhn, *author of* The Man Who Changed China: The Life and Legacy of Jiang Zemin, *is a Senior Advisor at Citigroup Investment Banking*

BIG SPENDER Bush's perceived lack of fiscal restraint has angered investors

ELECTIONS

FLIGHT OF THE INVESTOR CLASS

Defections are endangering the GOP's hold on power

BY RICHARD S. DUNHAM

THE INVESTOR CLASS IS souring on George W. Bush and the Republicans.

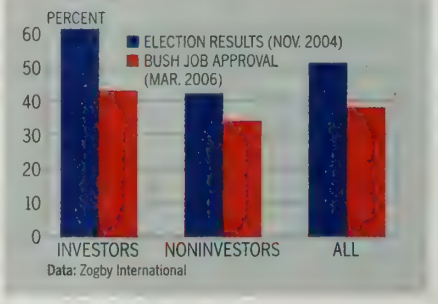
People who call themselves investors (and they aren't all rich) are part of the reason Bush's approval ratings have dropped to an all-time low. Hitoshi Tada has voted for the President twice, but the 27-year-old St. Louis resident and mutual fund investor says he's disappointed by Bush's "seeming lack of direction or progress on any front." Tada, who describes himself as "conservative across the board," isn't impressed by the management skills of America's first MBA President. "He certainly delegates and lets others screw up," Tada says. He calls the scandal-ridden Republican Congress "a hapless, self-serving mess."

Pollsters say 35% of voters belong to the investor class, a group that helped put Republicans in power but now seems restless. The investor class cuts across income levels and age ranges. It includes union members, soccer moms, and a growing share of Latinos, Asian Americans, and African Americans. Within each group, investors are more Republican than noninvestors. Among union investors, for example, 56% voted for Bush in '04, while 63% of labor's noninvestors backed Democrat John Kerry. The only good news on this front for Bush and his party is that most investors think even less of the Democrats. "I have no idea what their policies are," says Tada, an animal caretaker for a pet care service. House Minority Leader "Nancy Pelosi really freaks me out."

The President, who received the votes of 61% of investors in 2004, now gets favorable job approval ratings from just 43%, according to Zogby International Inc., a nonpartisan polling firm. Investors' complaints include the Administration's handling of Hurricane Katrina and the Dubai Ports deal, the management of the Iraq war, the $8.2 trillion national debt, soaring gasoline prices, and immigration policy. "A comfortable investor class votes its values and favors Republicans," says pollster Thomas H. Riehle of RT Strategies. "A nervous investor class votes its fears and punishes Republican incumbents."

That's what Republicans worry about most in Defections a this group hugely a midterm elec Even if Republicans win a bare majo investors by holding half of those have soured on Bush, the decline fror levels would amount to a 3.5 perce point shift in the national vote towa mocrats. "It could make the differen tween winning and losing in a num congressional districts," says GOP p Tony Fabrizio.

PRESIDENTIAL STOCK SLUMP



Data: Zogby International

THE KATRINA EFFECT

FOR NOW, MANY investors seem st limbo. They're alienated from Washi and skeptical that Democrats wou any better on economic issues. "They the same old, tired socialist messag tax cuts for the rich," says Norman 63, of Cranberry Township, Pa.

But that's cold comfort to Re cans, who realize that an increasing verse investor class could be Achilles' heel. Since 1980, the perce of Americans with mutual fund soared from 5.8% to more 50%. Although most investors are nomic conservatives, many are mo eral on social issues than the Reli Right loyalists who dominate th tional GOP.

For Bush, the fall has been swift ster John Zogby says the Presidentr cline started with the bungled react Katrina. Two years ago investors we percentage points more likely to vo Bush than were noninvestors. No vestors' views of Bush more closely ror national norms. "To investors, K turned out to be more of a defini ment than 9/11," says Zogby.

While investors say they're doing well financially, they are worried abo direction of the country. "In genera President has been good for inves says Carolyn Fermoyle, 56, a pro manager for Indiana University's Bend Division of Continuing Educ But "I am very worried about job wages in this economy. I still thinl part of the economy is a house of carc November she plans to vote again Republican congressman, Chris Cho

Bruce Bagley, 53, a small-bus owner in Santa Rosa, Calif., is more of what would happen if Dem take Congress. Investors would ha bull's-eye on [their] back," he clai anxious investors stray from the they could help Bagley's night come true. ■

We want you to know

Aetna's Information

"By far the richest online selection of the Big Three."

–*BusinessWeek*

In *BusinessWeek* magazine's recent comparison of Web sites and information tools offered by the top three national health insurers, Aetna received the highest marks. According to their article, they "found the richest set of offerings at Aetna's site." And Aetna's online survey to help members evaluate and manage their health was said to be "the most comprehensive." To learn more about how our information can help your employees make better health care decisions, call your broker, Aetna representative, or visit us online at aetna.com.

We want you to know℠

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200615

THE NET

YOUR AD HERE. AND HERE. AND HERE

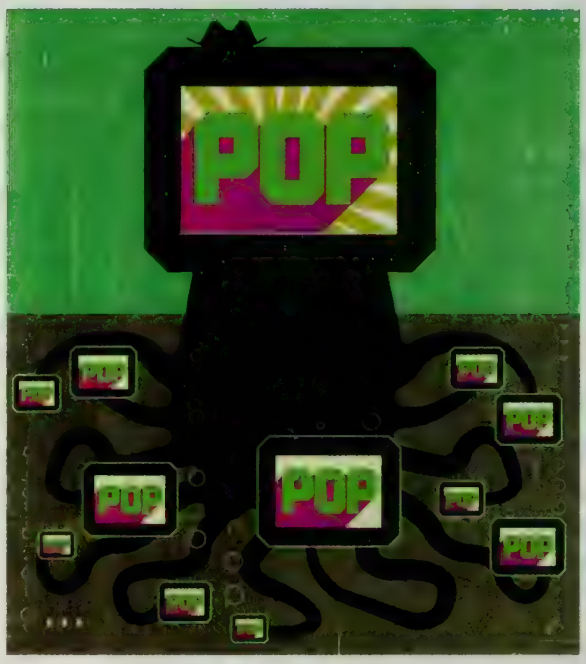
How a web of middlemen is hijacking the placement of online ads—and cashing in

BY BRIAN GROW AND BURT HELM

WOE UNTO THE Web surfer who visits www.easycracks.net. The site, popular with curious teenagers, offers free code used to unlock bootleg copies of everything from Windows XP to video games. But click a link to download a pirated program, approve one pop-up window, and secretive programs install themselves on your PC. Then this "adware" generates endless pop-up ads from well-known companies such as AT&T, eBay, and Internet phone service provider Vonage Holdings.

It's one example of how some questionable characters are hijacking the placement of online ads as big companies pour billions into Web marketing. On Apr. 4, New York Attorney General Eliot Spitzer filed fraud charges against Internet marketing firm Direct Revenue LLC for allegedly sneaking adware onto millions of PCs. Direct Revenue calls the lawsuit baseless.

The gravy train starts with big advertisers. The companies they hire, such as Yahoo! and Google Inc., tally the clicks the ads generate and charge accordingly. But to juice the returns, those outfits sign up partners who distribute the ads in return for a fee, and those partners sign up other partners. With each layer vying for more locations to showcase lucrative ads, there's an incentive for someone along the line to deliver them via surreptitiously installed programs. Says Ed English, chief technology officer for antispyware products at security firm Trend Micro Inc.: "We're seeing new trick after new trick."



Advertisers have little idea how or where their brands will pop up

An analysis by computer security firm Sana Security Inc. of San Mateo, Calif., shows how such a scheme works. At easycracks.net, users who want to download codes to obtain unauthorized copies of Microsoft Office 2000 are asked to install a type of software, known as ActiveX controls, offered by Dutch firm E.C.S. International. But approving the installation causes at least 16 other pieces of adware to download. None ask for permission to install themselves on PCs, according to Sana. They quickly deliver as many as five pop-up ads per minute.

That setup could generate subst income. Mike Friedman, business opment manager for E.C.S., says it easycracks up to 30¢ per installati the adware programs on U.S.-base So for each PC loaded with 16 prog easycracks could earn up to $4.8 turn, E.C.S. makes money from br who pump ads through its ad Friedman admits his company's agreement does not clearly disclos 16 pieces of adware will download PCs. E.C.S. is changing the agree he says, and as a result of *Business* inquiry it is investigating easyc Easycracks, whose Web site says based in Armenia, did not respo e-mailed requests for comment.

Big advertisers sa difficult to track thei "They put your nam over some pop-up ad, eBay spokesman Durzy. "As we be aware of them, we tal tion to get them to But analysts say comp are only beginning to a ly police ad networks. vard researcher Benjar Edelman says a Vona traveled through as m eight subdistributors appearing on the P users who visited cracks.net. Vonage sp woman Brooke Schul the company immed notified its online ad a a unit of ad conglon Arnold Worldwide Par after it was contacte *BusinessWeek*.

In a separate study, Edelman s how ads purchased for placeme Yahoo and partner sites by comp such as Cablevision Systems Corp. also redistributed until they show as pop-ups. According to Ede Yahoo became blind to the trail own ads. One partner, Ditto.com sented a Yahoo ad through anothe NBCSearch (not affiliated with t network). That company passed it to one of its own partners. (NBCS and Ditto.com did not respond quests for comment.) Sometime ads showed up in pop-ups from sp programs. In a prepared state Yahoo says it "takes the quality search ad distribution network ver ously. We are carefully investigatir claims that have been raised."

–With Ben Elgin in San Mateo,

are changing... With a new shape, formed by the energy of thousands
"a job well-done". From design through to service comes an approach
ssuringly fresh from beginning to end. A change set to leave its hallmark
world. From Europe's fastest growing airline...Turkish Airlines

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TURKISH AIRLINES

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ADVERTISING

BET YOU CAN'T TIVO PAST THIS

Companies aren't just pitching their wares on shows, they're producing them

BY BURT HELM

THIS SHOW IS ABOUT THE moments in our lives that are delicious in every way," purrs Chef Jacky Pluton at the beginning of *The Fairway Gourmet*, which runs on PBS. "I'm going to bring you to the most beautiful places in the world to play the game of golf...[and] taste the local flavor."

Sounds idyllic, no? It will be, and not just for Pluton and his viewers. Whoever picks up *The Fairway Gourmet* for its second season will pay nothing to produce or air the show. Meanwhile, the folks actually footing the bill will use the program to subtly pitch their wares to affluent baby boomers. Who's the backer? Here's a hint: Every resort next season will be in the state of Hawaii. "It's a perfect opportunity for us," says Jay Talwar, the Hawaii Visitors & Convention Bureau's marketing chief.

Yes, the line between what's an ad and what's a TV show is getting more blurred all the time. Not only are companies creating entertainment to flog their stuff to viewers, they are getting increasingly cagey about it. The aim is to make the message so veiled that viewers don't notice they're essentially watching one big ad. It gets better: The networks can sell ads around the, um, ad. "It's not about putting [the product] everywhere anymore," says Laura Caraccioli-Davis, director of Starcom Entertainment, which helps place products and brands in shows. "It's about getting viewers to lean in and pay attention, and then connect with them in other ways."

While product placement has been a fact of viewing life since the earliest days of TV, the proliferation of ad-zapping technology such as TiVo has made the practice a priority for advertisers. Placements are showing up practically everyw from the prominent Coca-Cola cu the hands of *American Idol* judges t Buick LaCrosse that actress Eva Lon hawked in an episode of *Desperate H wives* last fall.

Win-Win Deal

Why advertisers and programmers benefit from shows built around one product or brand:

ADVERTISERS

By creating a show from scratch, they can attract a defined audience with a tailored message, rather than trying to cram a product into an existing show. This can be more cost-effective than traditional advertising, too.

PROGRAMMERS

With production costs paid for by advertisers, they can sell ads around the free show. Plus advertisers often cross-market the program—promoting it in print ads and TV spots—which helps boost ratings.

CLEANING UP? *Exposing the Order of the Serpentine* promotes AXE body wash

TAILORED MESSAGE

THE IDEA OF BUILDING story around products got a big lift wit runaway success of programs such a *treme Makeover: Home Edition*. In th ABC show, cast members using products and Ford automobiles houses for poor families. Now all kir companies are cooking up their ow vertainment. Goen Group, maker o pill Trimspa, is developing *Million I Makeover Challenge*, a weight-loss r show. Sporting Bet PLC, the British er of the Aces.net gambling site, has a pilot for a game show. And Unileve together two specials built around iti Shower body wash: *The Gamekille* MTV and *Exposing the Order of th pentine* on SpikeTV.

Advertisers love the fact that the tailor a message to a specific aud *Fairway Gourmet* lets the Hawaii Vi & Convention Bureau court free spe who like to travel in style. The un ing message islands aren for beach b they have p to offer the ing foodie, "Ad placer weren't goi move the dial give budget," says T who hopes PBS agree to carry Hawaii edition. has an audience coveted for year

Sometimes ducing a show advertisers bang for the too. The prod costs of the H edition of *Fa Gourmet* will $40,000 $50,000 per hour episod cording to o the show's pr ers, Direct light Media. about what it cos place a 30-second with a middle-tie

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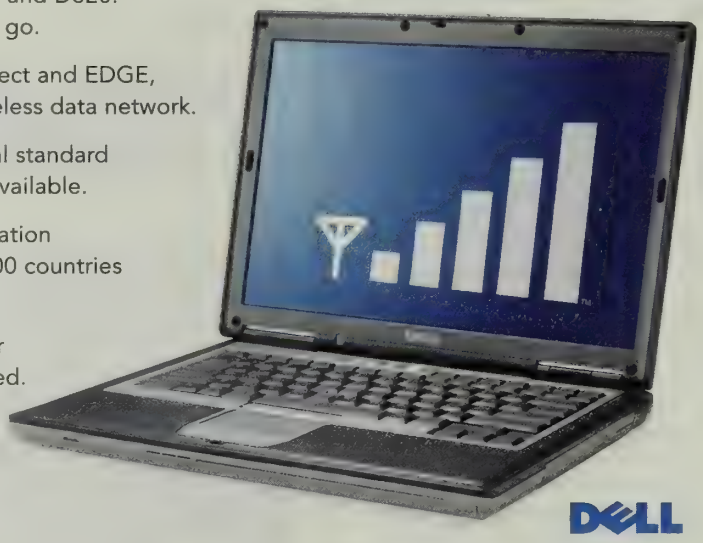

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tournament on CBS or NBC, according to Nielsen Media Research figures. A golf tourney attracts far more viewers than *Fairway Gourmet*, but getting half an hour to push a brand—if only subliminally—beats 30 seconds.

And even when production costs eclipse those of a traditional ad campaign, advertisers see benefits. The AXE shows are a case in point. Each one depicts the trials and tribulations of twentysomething woman-chasers. The program goes light on AXE products, but during the commercial break, the viewer sees an AXE spot in which a guy attracts swarms of women. "We are entertaining young guys, and then we show them AXE is master of the 'mating game,'" says AXE brand development director David Rubin. "Fifteen-second ads are limited, [and] product placement is good for sticking your name in something. It's not good for telling brand-level concepts."

Hawaii is footing the bill for *Fairway Gourmet* episodes

RATINGS POP

IT'S NO SECRET WHY the networks like advertiser-generated content. Typically advertisers foot the entire production cost of the show or pay for a portion and agree to buy big blocks of advertising on other shows in return. Sometimes, the advertisers refer to their shows in their print and TV ads, which can generate a nice ratings pop. And of course the TV guys sell ads against the program.

Building a show around a brand or product is not without risk, of course. Programmers stress that the show must be entertaining. They won't pick it up just because a big advertiser is behind it. And while they are open to having advertisers as production partners, network and cable executives say shows need to mesh with whatever channel they run on and contain no false marketing claims.

For advertisers, it's critical to strike the right balance. Push the brand too much, and viewers could resist the hard sell. Making the show appear independent and unaffiliated could backfire if people find out they've been had. But hit that sweet spot, say marketing experts, and advertisers will have potential customers fast-forwarding their TiVos just to get back to...the advertisement. ■

FLYING IN FLORENCE Some 40% of Italy's 4 14-year-olds tune in

SPORTS

AMERICAN GLADIATORS

Nothing pulls in the *bambini* like the WWE

BY DIANE BRADY

FOR A GLIMPSE OF THE FUTURE of World Wrestling Entertainment Inc., look beyond the fist-pumping rowdies at WrestleMania 22 in Chicago, which aired in early April, to the land of *amore* and Armani. Across the Atlantic, crowds of little boys, some barely old enough to write their names, are addicted to the body-slamming antics of men five times their size. They scream for rapper-wrestler John Cena at the famed Sanremo Music Festival. They snap up everything from WWE T-shirts to trading cards with a rabidity not seen since the early days of Nintendo Co.'s Pokémon.

In the U.S., WWE's popularity has dipped in recent years amid a boom in reality TV and a paucity of hunky new stars. But now, Stamford (Conn.)-based WWE is coming back, thanks in part to a hot new growth market: Italy.

THE STAT

36

Hours it took for 70,000 WWE T-shirts to sell out in Italy last year

There, some 40% of between 4 and 14 tune *WWE SmackDown* week. Retail sales zoomed from zero to million in just two yea

But the sudden ub of the garish Ame "sport," combined wi youth of its fans, ins such controversy in that some groups call laws to restrict childr and under from wat wrestling on TV and events. "It exploded s in this country," says fano Benzi, who covers WWE for Italia TV. "People didn't understan this was just a show."

PLAY NICE

THE SOLUTION: a public-relations paign that has stars preaching, iro ly, antiviolence. The WWE formed for Childhood with members of th ian Parliament's Committee on Chi Its aim: Warn fans not to copy wha see on TV. That has helped blu most potent critics.

Calming the furor is crucial since national sales are growing at a 35% al clip. The buzz from abroad has the thinly traded $17 stock rise mor 75% since last spring. WWE is also starting to garner more attention at But while ratings are up for *Monday RAW* on USA Network and DVD sal booming, veteran media analyst Der McAlpine is "waiting for a superstar me on the nose."

The musclebound stars get a lot love in Italy, where WWE's overwr story lines strike a nerve. WWE sc coup there because all the element strategy, from live events and tele to licensing deals, w sync beforehand. kids got excited, lice were ready to sell of merchandise at kiosks.

Says Chief Exe Linda E. McM "We're attracting who can grow up wi brand." Given the c tition at home, thos in Italy may pac punch WWE needs.

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AND HOW IT CAN SPUR

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TAIWAN

THE HOTTEST TECH OUTFI YOU NEVER HEARD OF

Peter Chou's high standards, and an alliance with Microsoft, have turbocharged handset maker HTC

BY BRUCE EINHORN

BILL GATES HAS A SECRET weapon—a little-known Taiwanese company with the bland name of High Tech Computer Corp. Microsoft Corp. has long wanted to extend Windows territory to include smartphones, those souped-up handsets that can duplicate many of a desktop's functions. But Microsoft needs partners to make the gadgets, and a key one is HTC. Microsoft collects a royalty on every Windows-operated smartphone and PDA phone HTC sells to cellular operators like Cingular, T-Mobile, and Vodafone, who in turn slap their own brands on its devices. The collaboration between Microsoft and HTC is intense. "There's shared DNA across both companies," says Scott Horn, general manager of Microsoft's Mobile & Embedded Div.

What keeps Microsoft loyal to this obscure operation? Peter Chou, HTC's demanding boss. While many Taiwanese companies have a reputation for cutting costs to the bone, HTC's president often takes the expensive step of forcing his engineers back to the drawing board to get things exactly the way he wants them. For instance, Chou sent a new handset model code-named "Star Trek" back to the lab repeatedly because he wasn't satisfied with its sound and video features. "This is the fourth generation, but the first one we'll ship," he says. "I killed the first three."

Chou has declared the latest Star Trek a winner. The phone is loaded with features, including an MP3 player, camera, and e-mail, all running on a slimmed-down version of Microsoft's Windows. His Seattle partner is wowed. "You almost never know what Peter is going to show up with in terms of new designs," says Horn. Chou is especially proud of Star Trek's sleek clamshell silhouette, which he says makes it the thinnest smartphone on the market. Customers, he says, might have been disappointed by the previous versions. "If you ship mediocre [products], that cools all the passion," he says.

Passion is good for profits. While many Taiwanese rivals have been suffering from shrinking margins and stiff competition, HTC is enjoying Google-like growth. On Mar. 30, the company announced that last year's sales had doubled, to $2.2 billion, with profits tripling, to $356 million. That has pushed its stock up by more than 1,000% since 2003.

Most industry analysts see no sign of a slowdown, either. Although they represent just 6% of cellular handset sales today, by 2009 smartphones will rise to 26%, researcher Gartner estimates. That should help push HTC's revenues to $5.3 billion next year, with profits of $988 million, JPMorgan Chase & Co. predicts. First-quarter 2006 sales were up 81%, thanks in part to sales of cool-looking gadgets like the Universal, a PDA phone with a swivel scre

HTC's relationship with Microso gan in 1997, when a team of enginee the Taiwanese subsidiary of I Equipment Corp. to launch HTC. quickly decided to concentrat portable gadgets that operate on dows. The Taiwanese engineers can with one of the first Windows hand which became Compaq Computer' ular iPAQ.

Then in 2002, HTC developed th Windows smartp "We didn't want back to [making] s or notebooks—it w boring," recalls Chen, the No. 2 em at HTC, who now sees research and opment. Over the engineers from HT worked closely wit Microsoft counte and Chou himse takes the Taipei- nonstop four times to meet Gates, Mi Chief Executive Steve Ballmer, an top Microsoft execu

Now HTC is w that Seattle adv more than ever. U cently, HTC had pl engineers workin Microsoft but alm body on the grou ing to sell to An operators. So las Chou hired To Achilles, who had T-Mobile Interna

HOT Gadgets

243%
HTC's sales increase since 2003*

559%
HTC's profit increase since 2003*

1,055%
HTC's share price increase since 2003**

*2003-2005 **Jan. 2, 2003-Apr. 12, 2006
Data: HTC Corp., Yahoo! Finance

lset purchases in the U.S., "to really things off," as Achilles describes it. To- HTC has 20 people at its U.S. head- ters, located—of course—in Seattle, Achilles expects to double that number arend.

SUS BUREAU CONTRACT

LE HTC DOESN'T reveal the size of .S. sales, the new push seems to be king. In January, Cingular Wireless ounced plans to offer a version of the Trek phone. On Mar. 30, Harris Corp. lelbourne, Fla., won a $600 million ract to provide 500,000 Windows rtphones to the U.S. Census Bureau. gadgets, to be used by workers in the census, will be supplied by HTC. On 5, Modeo LLC, a U.S. company plan- to offer TV on cell phones, an- nced it will be using HTC handsets for ervice.

ack in Taiwan, HTC stands out from ack in other ways. Rivals have diver- d away from their original business, ching out into liquid-crystal-display els and consumer electronics, but HTC still just does wireless devices. Other companies are trying to get into the business, but HTC's early commitment to Windows gives it a big edge. "There continues to be little competition for HTC on Microsoft smart devices," Joey Cheng, an analyst with Goldman Sachs Group Inc., wrote in a Mar. 13 report. Well, there's some: Last year, Motorola Inc. unveiled plans for a sleek Windows smartphone called Q. The phone, expected to be available by early April through Verizon Wireless, has been delayed until later in the spring.

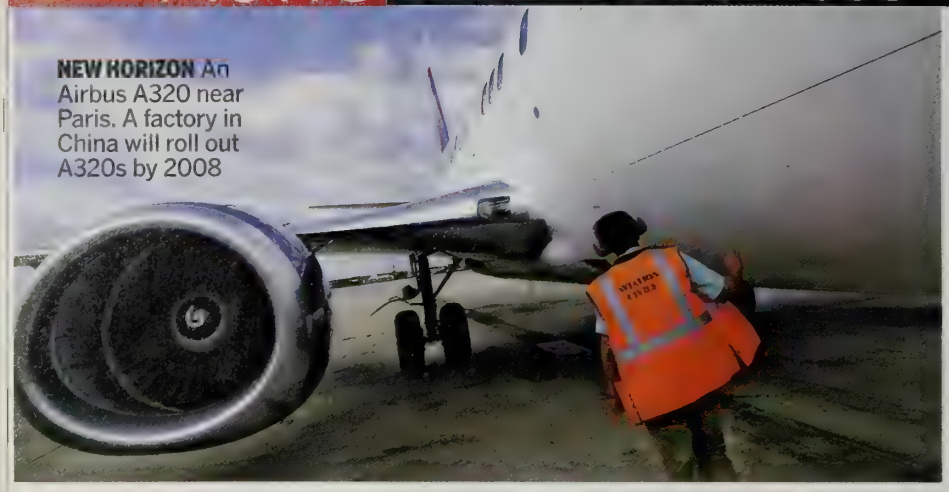
That leaves two big challenges for the Taiwanese company. While HTC dominates in Windows devices, smartphones using software from Symbian Ltd., the British consortium backed by Nokia Corp., now command three-quarters of the worldwide market, vs. 8% for Windows, researcher Canalys estimates. HTC's ties with Microsoft make it difficult to develop phones using Symbian software or other alternatives such as Linux. Another threat comes from Research in Motion Ltd.'s BlackBerry, the gold standard for mobile e-mail. HTC is working with Microsoft to launch an alternative called Direct Push that may be cheaper for operators. HTC plans to promote its own Direct Push phones soon.

PERFECTIONIST
Chou's dedication to high quality has won plenty of fans

Meanwhile, Chou is looking ahead. Last year he established a new research and development division called Magic Labs. Asked to come up with ideas for completely new products, the Magic Labs engineers choose their own whimsical titles such as mechanical wizard or software magician. "We give people the freedom to do whatever they want, even on their business card," says John C. Wang, the lab's self-proclaimed "chief innovation wizard."

"We are looking at totally new categories," says Wang, who won't offer any details. But no matter what Wang and his magicians come up with, chances are that Grand Wizard Chou will send them back to the drawing board more than once. ■

–With Jay Greene in Seattle



NEW HORIZON An Airbus A320 near Paris. A factory in China will roll out A320s by 2008

AEROSPACE

AIRBUS MAY HIT AN AIR POCKET OVER CHINA

Why its plan to build narrowbody planes there could come up short

BY CAROL MATLACK

IT LOOKS LIKE A GREAT LEAP forward for Airbus. The European planemaker is set to announce the site of an assembly plant in China, its first ever outside Europe. The facility, likely to be built near Beijing or Hong Kong, could start rolling out A320 planes by 2008. The plant is part of a major push by Airbus to pull even with Boeing Co. in China's fast-growing aviation market. Airbus first disclosed plans for the factory last December when it inked a $10 billion deal with China for 150 narrowbody A320s. With China's low labor costs, the promise of free land, and the prospect that Airbus' investment could spark more Chinese orders, the factory seems a smart bet.

Well, maybe not. Airbus isn't likely to save money building planes in China. Wings, fuselages, and other components would still be made at Airbus' European factories and shipped to China for assembly. The expense of transporting them and setting up a complex supply chain, along with recruiting and training Chinese workers, would wipe out labor cost savings, analysts say. Airbus executives, citing the sensitivity of ongoing negotiations, declined comment. But a spokesman acknowledges that Airbus' main reason for the plant is to gain greater access to the Chinese market.

A Chinese factory, though, could exacerbate an Airbus problem: an overreliance on lower-margin narrowbody sales while Boeing wins more orders for widebodies. Because 85% of the 1,055 orders logged by Airbus last year were for narrowbodies, its order book was worth $10 billion less than Boeing's, although Boeing sold 53 fewer planes. The pattern held true in China. While Boeing on Apr. 12 announced a $6.4 billion deal to sell 80 slimmer 737s to China, its recent Chinese orders have been split between narrow and wide planes. Boeing's order book includes 74 new 787 widebodies, totaling about $9 billion. By contrast, more than three-fourths of recent Airbus China sales have been the narrow planes. A Chinese A320 plant will give officials even greater incentive to swing narrowbody orders to Airbus. Says Richard L. Aboulafia, an aerospace analyst with the Teal Group in Fairfax, Va.: "It is a massive self-inflicted wound."

Why doesn't Airbus try building bigg planes in China? It is, after all, launchi a new widebody, the A350, to comp with Boeing's new 787. The problem Chinese industry has neither the techn cal expertise nor the financial resources play a role developing new aircraft. Japan, Boeing has long relied on giai like Mitsubishi Heavy Industries, F Heavy Industries, and Kawasaki Hea Industries. All have knowhow in comp ites and other technologies. And w loans provided by the Japanese gove ment, they're also shouldering abo 40% of the 787's development costs.

"SYMBOLIC MOVE"

AIRBUS ALREADY buys components fr Chinese suppliers, including emerger exit doors and engine mounts. It a vows to double Chinese procurement $120 million annually by 2010. Even the company estimates that just 5% of new A350's components will come fr Chinese companies, which aren't yet a to supply complex parts such as wings.

Even basic assembly in China has panned out for some Western airc makers. Brazil's Embraer, which oper a factory in Harbin in 2002 to make gional jets, has so far delivered only n planes. McDonnell Douglas, the U aerospace company later acquired Boeing, set up a factory in Shanghai the 1990s to build MD-80 and MD jets. Plagued with quality problems logistical snafus, it produced 55 pla before being shut down in 2000.

Airbus figures the risks are worth t ing to gain an edge in China, wher now has just a 30% market share. C nese carriers are expected to order alm 2,000 planes over the next 15 years.

China has also made clear it want create its own aircraft industry. So Air may figure that by building plants loc it can forestall devel ment of a Chinese c petitor. "Airbus is be farsighted. It's a whiz, highly symb move," says Ma Craigs, president Aerospace Forum A a Hong Kong-ba group representing ation suppliers. But now, Airbus' ticket China sure doesn't like a bargain. ■

–With Stanley Ho in Seattle and Frec Balfour in Shan

The Bet On China

ASSEMBLY Building factory to assemble A320 narrowbody planes starting in 2008

PROCUREMENT Doubling purchases from local suppliers, to $120 million annually by 2010

ENGINEERING Employing 500 Chinese engineers to help design the new A350 aircraft

Data: BusinessWeek

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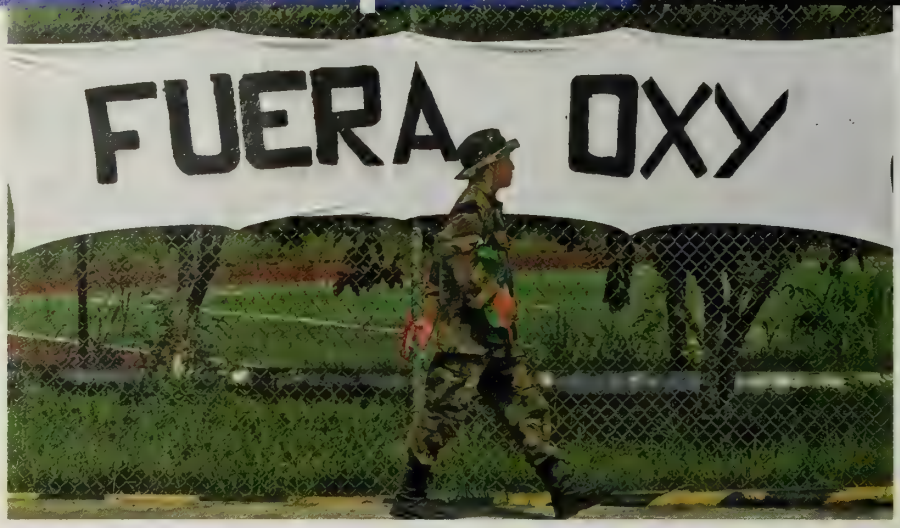

"OXY OUT" Demonstrators against globalization have called for its expulsion

The Heat on Oxy In Ecuador

It faces an onerous tax, and even the possibility of losing its oil fields

BY CHRISTOPHER PALMERI AND GERI SMITH

OCCIDENTAL PETROLEUM CEO Ray R. Irani learned the oil business at the side of Armand Hammer, Oxy's legendary, globe-trotting founder. Since then he has dealt with bomb-planting guerrillas in Colombia, negotiated billion-dollar deals with Middle East potentates, and sipped tea in a desert tent with Libyan strongman Muammar Qaddafi. Now the 71-year-old Lebanese-born exec is facing one of the thorniest political battles of his career in an unlikely place: Ecuador.

The small country on the western coast of South America is the eighth-largest supplier of oil to the U.S. As in other nations awash in oil money, the sight of so much wealth flowing to foreign corporations has exacerbated the frustrations of many Ecuadoreans, who confront widespread poverty. That puts companies like Oxy, which generated 7% of its worldwide production from its Ecuador fields last year and is the country's top private producer, in the political crosshairs. In mid-March, years of simmering resentment among members of the country's poor indigenous population exploded over a proposed free-trade pact with the U.S., and many citizens took to the streets in protest, calling for Oxy's expulsion. President Alfredo Palacio sent riot police to quell the disturbances. Although tempers have cooled somewhat, Irani's troubles have not. On Mar. 29, Ecuador's Congress instituted a windfall profits tax of 60% on oil producers, triple the normal rate. Moreover, Oxy has become embroiled in a nasty legal dispute with the government. At best, Oxy will pay a hefty settlement; at worst, its oil fields could be taken back.

DEEP POCKETS

OXY IS NOT IN any mortal danger. The Los Angeles company earned $5.2 billion last year on revenues of $15.2 billion. In the past three years its shares have tripled in value, helping it win the No. 6 spot on the BusinessWeek 50 list of top corporate performers. Irani himself pops up regularly at the top of exec pay lists: His compensation for 2005 was $50 million. Still, the Ecuadorean battle could stymie Irani's ambitious plans to raise Oxy's overall production from 596,000 barrels a day to nearly 1 million by 2(The troubles in Ecuador, combined v Oxy's soaring stock, prompted Friedn Billings, Ramsey Group Inc. energy a lyst Jacques Rousseau to downgr Oxy's shares on Mar. 30. "Nobody re knows how this is going to go," he sa

Occidental's troubles began in 2 when Ecuador decided to stop giving eign oil compa tax rebates on l goods and serv That cost Oxy, wh has invested $ million in its Ecu fields, $75 mill Irani appealed tc ternational arbitrators, who ruled in C favor in July, 2004. Soon after, Ecuac attorney general began an investiga into Oxy, accusing it of improperly tr ferring an interest in its fields to Cana producer EnCana Corp. in 2000.

Now Oxy faces the possibility of lo its fields. Last August, Ecuador's st owned oil company determined that had acted improperly and recommer taking the fields back. As anti-globa tion protests boiled over in March, I offered to pay the government $1 bil which would include back taxes, futu revenues, and $100 million for social grams. In return, Oxy's contract woul extended. Local political analysts say while Oxy is unlikely to lose the fields manently, President Palacio will ha take substantial action to appease electorate. "A few months ago heavy might have worked," says Gustavo Ar an economist at consulting firm L Source in Ecuador. "Now Palaci backed into a corner."

Irani declined to spea *BusinessWeek*, citing the s tivity of the situation. (chief legal counsel in Ecu Daniel Almaguer, expects of expropriation to blow and for a settlement tc reached. "This is an election year," he

The government is likely to mov diciously, given that Oxy is Ecuador' private taxpayer. But there's anc geopolitical twist: In February, En sold its Ecuadorean assets—includir share of Oxy's fields—to a joint ver of Chinese companies for $1.2 billio Oxy is forced out of Ecuador, I'm someone else will knock on the do say they can develop the project," Roger Tissot, director of country analysis at PFC Energy in Washin D.C. Irani will need all his political to prevent that from happening. ■

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Cerberus to KKR: Eat Our Dust

Stephen Feinberg's fast-growing hedge fund snatched GMAC. But it's a risky play

BY EMILY THORNTON

IT WAS AN EPIC SHOWDOWN BETween legendary buyout king Henry R. Kravis and New Age hedge fund manager Stephen A. Feinberg—and Feinberg won. On Apr. 3, General Motors Corp. announced that it would get about $14 billion over the next three years for selling a 51% stake of its highly profitable GMAC finance division to a group led by Feinberg's firm, Cerberus Capital Management LP.

Ever since, Wall Street has been buzzing over how the 46-year-old Feinberg snapped up a huge financial-services company for little more than its book value from Kravis, age 62. Kravis may someday look wise for having turned his back on a deal heavily laden with risk. But losing to Cerberus has to sting.

A big battle between established buyout firms such as Kohlberg Kravis Roberts & Co. and scrappier hedge fund groups like Cerberus—named after the three-headed dog in Greek mythology that guards the gates of Hades—has been brewing for a while. In a 2004 speech to a few hundred private-equity investors and bankers, Kravis warned that hedge funds had little experience managing companies or "creating value."

Since then, Kravis has been forced to fend off Feinberg multiple times to buy companies. In 2005, a KKR group beat out Cerberus for troubled retailer Toys 'R' Us Inc. by paying $6.6 billion for it. In January, a Cerberus group picked up the grocery chain Alberston's Inc. that KKR had been eyeing.

The next round came when GM sold most of GMAC's commercial mortgage unit to a group led by KKR on Mar. 23. (GMAC sells auto financing, mortgages, and insurance.) Little more than a week later, Cerberus beat out KKR for the big kahuna—a majority stake in GMAC itself. That means Cerberus is indirectly a part-owner of KKR's commercial mortgage business. Kravis may have to deal with Feinberg whether he likes it or not.

"APPLES TO ELEPHANTS"

FOR FEINBERG, snagging GMAC means much more than besting Kravis. He hopes the deal will propel Cerberus from a behind-the-scenes operator into a well-respected financial-services company. That's a big leap for a private investment firm that started with a grubstake of $10 million in 1992. Cerberus now manages $18 billion in assets, excluding the GMAC deal (BW—Oct. 3).

GM could have the option to buy back GMAC

Feinberg won the day in part by accepting risks that every major bank and marquee buyout firm that GM approached about the deal turned down. For starters, Cerberus will take control of more than $300 billion of leases, loans, mortgages, and insurance p cies. The auto-related leases and l could be a drag if GM's problems worse. Feinberg also agreed to in GMAC's aftertax earnings and divide for five years, and not to break G apart without GM's consent. In addit he promised to continue to sup loans to dealers and leases to buyer GM autos for 10 years.

During that time, GM will have option to buy GMAC back under cer conditions, including GM becomin investment-grade company. The b back rights "required a lot of flexib on the part of Cerberus, and [resul in a lesser initial sales price," says CEO G. Richard Wagoner. "We wa the most cash we could get, but flexi ty was more important." Adds Stan & Poor's credit analyst Robert Sch who reviewed the deal: "There's plenty of remaining risk."

The deal is so complex that even ple who saw the final bids mitted by KKR and Cerb disagree over how much offered. Some say KKR willing to pay a higher in price, but Cerberus would more in the long run by investing in GMAC and ma other commitments. Ot dispute that. "The offers so different that they were apples to oranges, they apples to elephants," says adviser who asked not t named. Nevertheless, Wall Street is over the unprecedented $6 billion c that Cerberus and some of its lim partners are writing.

Neither KKR nor Cerberus was first choice when it announced last C ber that it was going to sell a maj

of the division to a "strategic part- people close to the deal say. Rating ies Standard & Poor's and Moody's ors Service had made clear to GM MAC's credit rating could be sepa- from the struggling auto maker's f it sold a majority stake of the divi- a large bank. GM, whose own rat- d sunk to junk level, badly wanted to get its own, higher, rating: 's contributions to GM's earnings shrinking, in part because of rising wing costs. In 2005, it contributed billion to GM's earnings, down from billion in 2004.

ough many banks looked at the one were interested in swallowing alone—it was too risky. When GM to consider joint bids by banks and t firms in December, some of GM's rs thought KKR was a shoo-in be- the firm was already in the process of g a big chunk of GMAC's commercial age business. One person close to board denies this was the case.

NG OVER FILES

ST TWO MONTHS later, GM's ad- presented what were expected to be al two bids for majority stakes in to the board. KKR, with Wachovia , had submitted a highly condition- er and term sheet. By contrast, Cer- , which had code-named the GMAC "Hercules," had marked up every n of a purchase agreement and had tens of millions of dollars for ly 300 people to pore over 8,000 files and other documents.

R still wouldn't let up. In late Feb- it rounded up a group of blue-chip ers that might eventually get the investment-grade rating it d—General Electric, Wa- a, Merrill Lynch, and the Bank of Nova Scotia. But that didn't deter Cerberus. Not long after, Feinberg, notorious for his hatred of traveling far from his Park Avenue office, met Wagoner in Detroit in mid-March. His partner, Citigroup CEO Charles O. Prince III, also went to visit Wagoner on Mar. 23 to personally vouch for Feinberg.

Feinberg badly wanted the deal. Just weeks before the board met to make its final decision on Mar. 26, one Cerberus partner decided not to contribute $1.5 billion to the deal. Feinberg impressed the carmaker by saying he would not cut the price—and his firm would make up the difference.

By the time KKR tried to bust its way back in, "it was almost no contest," says someone close to the board. "I don't think there is any other financial institution in the world that would have done this deal." That's a fact—for better or for worse. ■

–With David Welch in Detroit, Mara Der Hovanesian and Diane Brady in New York, and Dean Foust in Atlanta

Why GM Did a Deal with Cerberus

SEPARATE CREDIT RATING FOR GMAC By taking a majority stake in GMAC and committing to reinvest all of the company's aftertax earnings and dividends back into its business for the next five years, the Cerberus group, which includes Citigroup and Aozora Bank, has persuaded rating agencies to delink GMAC's credit rating from GM.

QUICK CASH GM will receive $14 billion over three years, including $10 billion in cash when the deal is expected to close at the end of this year. Extra bonus: A $25 billion credit facility from Citigroup.

SUPPORT FOR GM GMAC will keep about half of GM's auto leases and continue to support GM's writing of new leases. Cerberus may sell the auto finance business back to GM if the auto maker meets conditions including obtaining an investment-grade credit rating.

Data: *BusinessWeek*

Mortgage Lenders: Who's Most at Risk

As delinquency rates rise, red flags are flying over some aggressive finance outfits

BY MARA DER HOVANESIAN

FOR MONTHS doomsayers have been predicting that the slowing housing market, along with rising interest rates, would lead to mortgage foreclosures and bank losses. That hasn't happened yet, but delinquency rates have started to rise. What's worse, instead of cutting back on the exotic mortgages they've leaned on throughout the boom, many lenders are charging ahead on such high-risk loans full tilt. "Mortgage lending standards show little sign of tightening," says Frederick Cannon, bank analyst with New York's Keefe Bruyette & Woods Inc. investment bank. "[Lenders] should have dialed back the aggressive loans by now."

Cutthroat competition, say banks, leaves them no choice. Even after then-Federal Reserve Chairman Alan Greenspan admonished lenders a year ago for enticing borrowers to take on more debt, many still require little or no documentation, ask for low n mum payments, offer loans that are as a percentage of home valuations, permit borrowers to carry more ov debt than in the past. Few lenders passed much of the rise in rates on to rowers either. "Both the banks and sumers are stretching," says Peter J. ter, an analyst with Harris Nesbitt Co unit of BMO Financial Group.

The much-feared troubles may final arriving. Delinquency rates jumped than 7%, to 4.7% in the fourth quart 2005, from the year before, accordi the Mortgage Bankers Assn. Home bu are becoming over-extended. In Califo where seven of the 10 most expensive cities are located, one in five buyers al spends more than half of pretax house income on housing—much more tha 30% recommended by the Housing & ban Development Dept.

Worries center around the subp lenders, which make loans to borro with less than stellar credit. Last they issued a record $650 billi mortgages. Such lenders now h 23% market share of new loan less than 5% in 1994, says Bren White, managing director at loitte & Touche Corporate Fin LLC. Periods of big profits are followed by "serious indigesti the market," she warns.

Many large subprime le sell their loans to Wall Stre repackage for investors to bu doing so, they argue, they mov from their balance sheets to broader market. Scott R. Co Bear, Stearns & Co. analyst co mortgage finance, disagrees. He the sales at 14 such lenders to j their appetites for risk, and to mine the quality of the loans they ly keep on the books. "They some skin in the game," he says

Coren highlights several potentia flags. ECC Capital Corp. and New Ce Financial Corp. do big business in Ca nia, where the median house price ju 16% last year, to reach a record $548 Long Beach Mortgage Corp. (a u Washington Mutual) and NovaStar F cial Inc. require only limited mentation and therefore m vite fraud, according to C research. Fieldstone Invest Corp. and First Franklin Fin Corp. write lots of loans call terest-only or option adjus rate mortgages, which allow rowers to postpone m repayments of principal and

HOUSING WATCH

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add unpaid interest to the debt. ECC and Long Beach declined to comment ahead of their earnings announcements. New Century says its California borrowers have solid credit and that it steers clear of loans with risky terms. First Franklin Financial says it sells off all its loans. A NovaStar spokesman says: "One variable doesn't explain the risk/return profile of an entire pool of loans." Fieldstone did not return calls.

Despite the lenders' precautions, some borrowers will receive a rude shock starting this year. Repayment terms on about $1.3 trillion of adjustable-rate loans will increase in 2006 and 2007, forcing some borrowers to pay up to 150% more per month. "In the hands of an unsophisticated borrower, [these loans are] dangerous," says Robert W. Visini, vice-president for marketing at San Francisco mortgage tracker LoanPerformance.

About 10% of U.S. households now face a great risk of running into credit problems, according to research done by Meredith Whitney, senior financial institutions analyst for CIBC World Markets Inc. If borrowers start to default on their loans, their lenders could themselves face mounting problems.

It has happened before. In the mid-'90s some banks were so desperate to issue mortgages that they were lending as much as 125% of a home's appraised value. When the economy weakened, several filed for Chapter 11 bankruptcy, including United Companies Financial, which was later liquidated. Caution to those lenders who are pushing the envelope today. ■

Perilous Portfolios

As the housing market softens, some lenders are still making riskier loans.

- **More than 35% of their lending in California:**
  ECC, Fieldstone, Long Beach, New Century, First Franklin Financial
- **Highest concentration of interest-only loans:**
  Fieldstone, First Franklin Financial
- **Biggest percentage of loans with limited credit documentation:**
  Fieldstone, Long Beach, Novastar

Data: Bear, Stearns & Co.

DELPHI IN MEXICO
Jobs abroad are set to grow

Go Bankrupt, Then Go Overseas

For Delphi, Chapter 11 is a globalization gambit. If it works, rivals may copy it

BY DAVID WELCH

DELPHI CORP.'S BATTLE with the United Auto Workers has all the earmarks of a conventional labor showdown. CEO Robert S. "Steve" Miller Jr. has demanded up to 40% pay cuts, which he says are necessary to lift the world's largest auto parts maker out of bankruptcy and make it globally competitive. The UAW has agreed in principle that concessions are inevitable but is adamantly resisting the scope of changes Miller wants.

But what's different in this ba that Miller wants to use the bank courts to drastically slash Delphi' presence, thus freeing it up to foc its already vast overseas produ Miller filed for Chapter 11 prot only for his U.S. operations, whic ploy 32,000 UAW and other workers. He was careful to exclud phi's 115,000-worker foreign fac many of which operate in low countries such as Mexico and Ch Miller gets his way, court filings Delphi will end up with a U.S. force of perhaps 7,000, leaving th of its production abroad. "The cor

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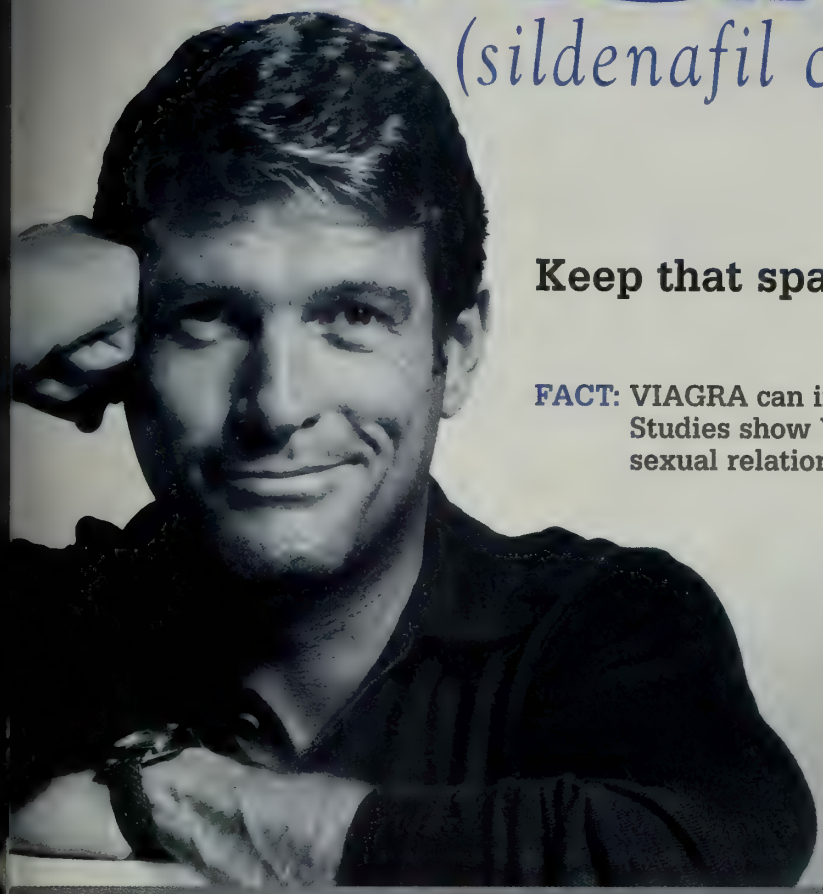

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AGRA is prescribed to treat erectile dysfunction. We know that no medicine is for everyone. If ı use nitrate drugs, often used for chest pain (known as angina), don't take VIAGRA. Taking ese drugs together could cause your blood pressure to drop to an unsafe level.

k with your doctor first. Make sure you are healthy enough to have sex. If you have chest pain, ısea, or other discomforts during sex, seek medical help right away.

hough erections lasting for more than four hours may occur rarely with all ED treatments in s drug class, to avoid long-term injuries, it is important to seek immediate medical help.

are instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) orted a sudden decrease or loss of vision. It is not possible to determine whether these events are ated directly to these medicines or to other factors. If you experience sudden decrease or loss of ion, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

e most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less nmon are bluish or blurred vision, or being sensitive to light. These may occur for a brief time. member to protect yourself and your partner from sexually transmitted diseases.

ase see our patient summary of information for VIAGRA (25 mg, 50 mg, 100 mg) tablets on the following page.

AGRA is covered under most Managed Care Plans.*

ent of members by formulary status for HMOs, PPOs and POS for VIAGRA. Formulary Compass™ MediMedia USA, Inc. October 2005.

portant Information: VIAGRA is one of several ED treatments that you and your doctor can consider.

insured? Need help paying for medicine? Pfizer has programs that can help, matter your age or income. You may even qualify for free Pfizer medicines. ll **1-866-706-2400.** Or visit www.pfizerhelpfulanswers.com.

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PATIENT SUMMARY OF INFORMATION ABOUT VIAGRA®

(sildenafil citrate) tablets

This summary contains important information about VIAGRA®. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

• What Is VIAGRA?
VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

• How Sex Affects the Body
When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

• How VIAGRA Works
VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

• VIAGRA Is Not for Everyone
As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

• What VIAGRA Does Not Do
- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV — the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

• What To Tell Your Doctor Before You Begin VIAGRA
Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- have ever had a stroke
- have low or high blood pressure
- have ever had severe vision loss
- have a rare inherited eye disease called retinitis pigmentosa
- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

• VIAGRA and Other Medicines
Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking alpha-blocker therapy for the treatment of high blood pressure or prostate problems, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as you take your dose of alpha-blocker.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

• Finding the Right Dose for You
VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period. If you are taking alpha-blocker therapy, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as your dose of alpha-blocker.

• How To Take VIAGRA
Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

• Possible Side Effects
Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

• Accidental Overdose
In case of accidental overdose, call your doctor right away.

• Storing VIAGRA
Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

• For More Information on VIAGRA
VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

Pfizer U.S. Pharmaceuticals

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only keep U.S. operations that have nological value," says Brian John- an auto analyst at Sanford C. Bern- & Co. Miller declined comment.

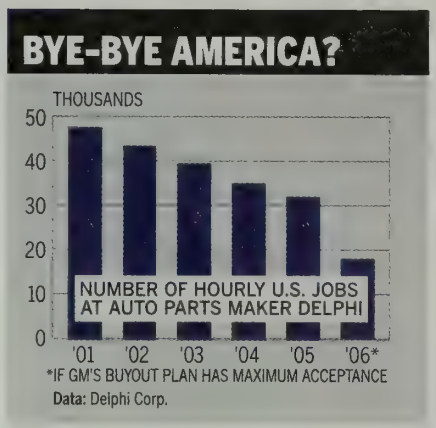
iller's is an unorthodox approach paves a new road for U.S. employers ing to compete in a globalizing omy. After all, U.S. bankruptcy laws written before globalization and in- ed to give companies a chance to re- nize and start over—not flee over- says Sean McAlinden, chief omist with the Center for Automo- Research. He says other auto parts panies, a handful of which already n bankruptcy, are likely to follow if Miller's strategy succeeds. That s the $170 billion annual auto parts ness could shift overseas even faster, ardizing more of the industry's 000 jobs.

STIC DOWNSIZING

ICS ARE TRYING to throw up all the blocks they can. On Apr. 6, two UAW s, Senator Evan Bayh (D-Ind.) and esentative John Conyers Jr. (D- n.), introduced legislation in Con- s to tighten up the bankruptcy laws sponse to Delphi's moves. The bills d require the courts to factor in a rupt company's overseas opera- s when determining whether it can gate union contracts and retiree h-care plans in the U.S. "Some in- tional corporations that are strug- g domestically use their losses at e to justify breaking contracts with rican workers while their overall pany is still thriving," the two law- ers proclaimed in their joint an- cement of the legislation.

iller doesn't talk much publicly t his goals for fear of further in- ing an already outraged UAW, but ist of Delphi's plan is apparent in its ruptcy filings. Right now the pany produces about two- ls of its $28 billion in an- revenue in the U.S. This des everything from -tech engine controls satellite radios to low- commodities such as air s and brake parts. Its re- nization plan would everything in the U.S. pt safety technology, s, information and rtainment systems,

ER Delphi's CEO lling for up to 40% e cuts in the U.S.



electronics, wiring, and engine controls. That would leave Delphi with U.S. revenues as low as $5 billion.

To pull off a downsizing of that scale, Delphi would close or sell 21 of 29 plants it has identified as noncore businesses, according to the filings. An additional 12 plants are not named in the reorganization plan, but a company spokesman says some of those will go, too. It's not just $27-an-hour union wage scales at issue. Even if the UAW agrees to slash pay to $22 per hour this year and to $16.50 per hour next year, as Miller has demanded, many of Delphi's plants are inefficient and would take huge investments to bring up to world-class standards. Bottom line: Delphi's plan would slice away 27,000 U.S. union jobs by 2010.

GM may end up subsidizing wages of Delphi's jobs in the U.S.

Many of these cuts will come with aid from former parent General Motors Corp. It's on the hook because it buys about $14 billion in parts a year from the company it spun off in 1999. If the UAW were to strike over Miller's demands, GM would be shut down in a couple of weeks, GM CEO G. Richard Wagoner Jr. tells *BusinessWeek*. That's why Wagoner agreed in March to take back 5,000 UAW workers from Delphi and offer early retirement buyouts to 13,000 more. It's also why he is still at the bargaining table, trying to grease a deal that will help Delphi cut costs while keeping its union workers off the picket line.

Indeed, Wagoner may end by subsidizing the wages of whatever jobs Delphi keeps in the U.S. UAW leaders say GM may pay as much as $10 an hour on top of the $12 Miller is offering his UAW members. Wagoner insists he won't take over any Delphi plants. But McAlinden thinks GM could wind up paying some of Delphi's wages, at least temporarily.

That may not be quite as crazy as it sounds. Consider that GM is currently subsidizing Delphi by paying $2 billion above market for the parts it buys from its former division, says Wagoner. If GM wage subsidies persuade the UAW to go along with Miller's plan to shutter more of its U.S. plants that supply GM, that would free up the auto maker to find cheaper suppliers. "We can work it out," Wagoner says. "The benefit to GM is that we can get parts at market-based prices."

For Miller, the preferred outcome is clear: exit high-cost U.S. operations in which Delphi is not competitive. McAlinden figures other suppliers—even healthy ones—will take similar steps. "You don't think that companies like Lear and Johnson Controls won't want to find a way to go overseas?" asks McAlinden. "You bet they will." ■

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Underdog Or Patent Troll?

How Burst.com went from making software to suing tech giants

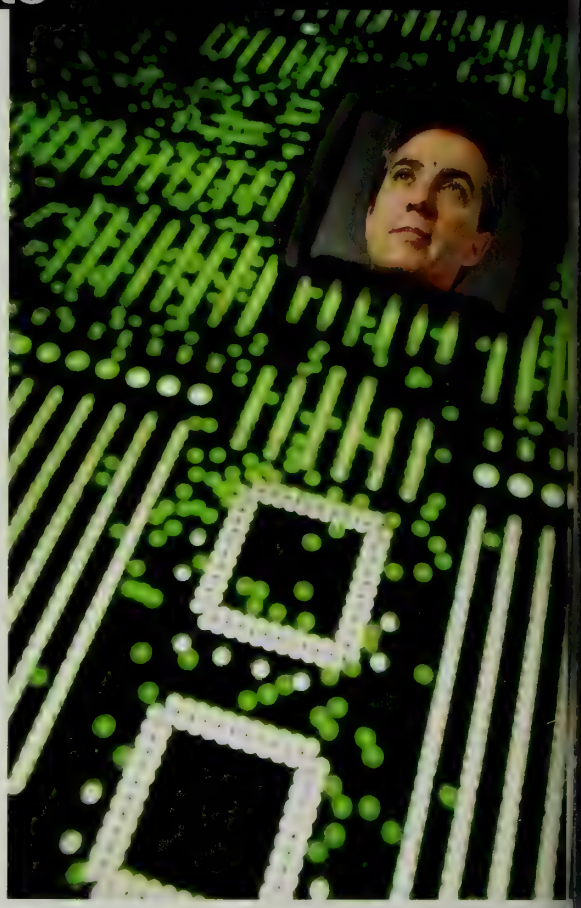
BY PETER BURROWS

RICHARD LANG COMES across as a mellow Californian. The youthful-looking 52-year-old lives on an 11-acre estate among apple trees in the hippy town of Sebastopol, north of San Francisco, where he plays guitar in local bands and his wife runs an "equine experiential learning institute" that helps clients get in touch with themselves by riding horses. But there's nothing laid-back about his strategy at Burst.com, the Santa Rosa (Calif.) company he co-founded 18 years ago. With just two employees, Burst holds 10 U.S. patents, and its focus is on asking big companies to license its technology—and suing them if they don't.

In March, 2005, Burst won a $60 million settlement from Microsoft Corp. The next target, Lang says, is Apple Computer Inc., which he says infringes on Burst's patents covering superfast transmission of content, such as songs and video, over networks. He's seeking a chunk of the tech giant's burgeoning music revenues, and says he plans to sue in mid-April if no settlement is reached.

That makes Burst, in many people's eyes, a "patent troll." In recent months tech giants such as Microsoft, Intel, and Yahoo! have vilified the trolls—tiny companies that don't make anything but simply hold a portfolio of patents. Their business plan consists of cashing in on this intellectual property by suing traditional corporations, the types that produce real products. That infuriates the targets of these suits, who claim that the legal risk forces them into exorbitant settlements, and that the ensuing payoffs increase costs for consumers. For many, the poster child for trolls is NTP Inc., the tiny company that extracted $612 million from Research In Motion Ltd., the maker of the BlackBerry wireless e-mail device.

But it was never Lang's plan to be in the litigation business. A legitimate visionary, he patented a method for transmitting data over digital networks that turned out to be years ahead of its time. His company once seemed poised to become a major tech player in its own right. But the hardball tactics of Microsoft blew apart Burst's original business model, Lang claims, and gave him no choice but to turn to the courts.



EYEING iPOD Lang's next target will be Apple, barring a settlement

While big companies have been c plaining that the patent system is t against them, Lang believes his demonstrates that the opposite is c true. "There's a million ways for a p tiff to lose a patent case but only one to win," he says. "So if you're a big company, why not go ahead an through the [legal] process? Mayb little guy will run out of money, or ru of courage."

The validity of Lang's tale of woe w timately have to be determined by courts, but right now he is not win many friends in Silicon Valley. Burst i serting very broad patents, and Lang been making the rounds with v threats of infringement actions. He's ing for big payments. While Lang v discuss his hopes for the Apple claim lawyer cites as a point of reference c cases in which plaintiffs were rewa more than 2% of infringing revenues. would be about $200 million so far fo ple. "Burst.com approached Apple cl ing that some of our products violate

TO THE WINNER GOES . . . NOT THAT MUCH

Here's what Richard Lang was left with after Burst.com's $60 million settlement with Microsoft got divvied up:

Burst shareholders	Lawyers	Burst working capital	Creditors	Lang and his w
$32 million	$20 million	$4 million	$1.5 million	$2.5 million

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WEBSHOTS

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ıts, but we don't agree," says an Apple esperson. On Jan. 4, Apple filed a suit ng to invalidate Burst's patents.

hile Lang is controversial, his record ech clairvoyant is impressive. When est of the world was focused on stuff- 00 channels onto cable TV, he was ing ways to use digital networks to er content more efficiently and reli- Lang recognized that shows could ent faster than they could be ed—in "bursts" that took full advan- of momentary increases in network city, rather than in constant ams." Indeed, at the 1991 Consumer ronics Show, Lang drew a crowd a demo in which 15-minute seg- s of a PBS documentary were zipped TV across the booth in seconds. y were demonstrating things that people couldn't do," says tech pun- obert X. Cringeley.

OUTSIDE THE BOX"

R SPENDING the 1990s trying to ct "real-time streaming" of con- -often in low resolution with tiny im- —titans including Apple, Microsoft, Real Media have since embraced 's general approach. "We were so outside the box that even in the late 1990s, people didn't get it," says Lang.

By the late '90s his company had grown to 110 employees and was selling a software package called Burstware. Then, Microsoft got in the way. When the software giant upgraded its Media Player software in 2000, suddenly Burst's key product stopped working. Lang is certain it was on purpose, a charge Microsoft denies. Regardless, Burst nearly went bust. Customers backed away, as did bankers who had been arranging a $70 million secondary offering for the company. Within months, he'd laid off all but four staffers and was begging Microsoft for a licensing deal. "Microsoft, like many big companies, wants to wear out their opponents," says Lang. In one e-mail, Burst's contact at Microsoft reported that the company was "going, going..."

His ideas for data transmission won the day. Now Lang wants a cut

Burst survived, though. Convinced that a 2001 release of Windows Media Player infringed on Burst's technology, Lang got an investor to put up $1.5 million to keep the company afloat as it pursued a lawsuit, filed in June, 2002. Without admitting liability, Microsoft agreed to the $60 million settlement a day before a hearing on whether it had destroyed evidence. Although the myth is that trolls get fabulously wealthy, Lang personally ended up with just a fraction of the settlement proceeds, $2.5 million.

Believing the victory validated his patent claims, Lang has expanded his search for licensees. Apple was his first stop, and not only because of its deep pockets. Apple reps had approached him at a trade show back in 1991, and Burst met with Apple in 1999, 2000, and 2002. "The attitude is exactly like it is at Microsoft and everywhere else. If you won't take next to nothing [for Burst's technology], we'll fight you for the next 10 years," he says.

That may well be what happens. Lang's patents have never been upheld in court, and Apple will be a formidable foe. But he insists his easygoing style doesn't tell the whole story: "I'm a bit of a terrier." ■

THE WORLD'S MOST INNOVATIVE COMPANIES

HEIR CREATIVITY GOES EYOND PRODUCTS TO EWIRING THEMSELVES. *USINESSWEEK* AND HE BOSTON CONSULTING ROUP RANK THE BEST.

Y JENA McGREGOR

IT WAS A FITTING WAY TO WRAP UP THE FIRST day of IBM's innovation-themed leadership forum, held in Rome in early April. Guests were treated to small group tours of the Vatican Museum, including Michelangelo's frescoes in the Sistine Chapel. They sipped cocktails on a patio in the back of St. Peter's, the vast dome of the basilica outlined by the light of the moon. They dined in a marble-statue-filled hall inside the Vatican. What better place than Italy to hold a global confab on innovation, the topic *di giorno* among corporate leaders? It was, after all, the birthplace of the Renaissance, another period of great innovation and change.

The next day, at the Auditorium Parco della Musica, 500-odd corporate executives, government leaders, and academics listened as a diverse group of innovative leaders took the stage. Sunil B. Mittal, chief executive officer of Indian telecom

company Bharti Tele-Ventures Ltd., described his radical business model, which outsources everything but marketing and customer management, charges 2¢ a minute for calls, and is adding a million customers a month. Yang Mingsheng, CEO of Agricultural Bank of China, the country's second-biggest commercial bank, spoke of building a banking powerhouse from a modest business making micro loans to peasant farmers.

Their stories echoed a comment IBM CEO Samuel J. Palmisano had made the day before: "The way you will thrive in this environment is by innovating—innovating in technologies, innovating in strategies, innovating in business models."

Palmisano, to be sure, was making a subtle pitch for IBM and its ability to help the assembled leaders do well in an increasingly challenging business environment. But he also summed up the broad focus of innovation in the 21st century.

Today, innovation is about much more than new products. It is about reinventing business processes and building entirely new markets that meet untapped customer needs. Most important, as the Internet and globalization widen the pool of new ideas, it's about selecting and executing the right ideas and bringing them to market in record time.

In the 1990s, innovation was about technology and control of quality and cost. Today, it's about taking corporate organizations built for efficiency and rewiring them for creativity and growth. "There are a lot of different things that fall under the rubric of innovation," says Vijay Govindarajan, a professor at Dartmouth College's Tuck School of Business and author of *Ten Rules for Strategic Innovators: From Idea to Execution.* "Innovation does not have to have anything to do with technology."

THE QUICK AND THE BLOCKED

TO DISCOVER WHICH companies innovate best—and why—*BusinessWeek* joined with The Boston Consulting Group to produce our second annual ranking of the 25 most innovative companies. More than 1,000 senior managers responded to the global survey, making it our deepest management survey to date on this critical issue.

The new ranking has companies evoking all types of innovation. There are technology innovators, such as BlackBerry maker and newcomer Research In Motion Ltd., which makes its debut on our list at No. 24. There are business model innovators, such as No. 11 Virgin Group Ltd., which applies its hip lifestyle brand to ho-hum operations such as airlines, financial services, and even health insurance. Process innovators are there, too: Rounding out the ranking is Southwest Airlines Co. at No. 25, a whiz at wielding operational improvements to outfly its competitors.

At the top of the list are the masters of many genres of innovation. Take Apple Computer Inc., once again the creative king. To launch the iPod, says innovation consultant Larry Keeley of Doblin Inc., Apple used no fewer than seven types of innovation. They included networking (a novel agreement among music companies to sell their songs online), business model (songs sold for a buck each online), and branding (how cool are those white ear buds and wires?). Consumers love the ease and feel of the iPod, but it is the simplicity of the iTunes software platform that turned a great MP3 player into a revenue-gushing phenomenon.

Toyota Motor Corp., which leapt 10 spots this year to No. 4, is becoming a master of many as well. The Japanese auto giant is best known for an obsessive focus on innovating its manufac-

The World's 25 Most I

Our 2006 list of the world's most respected names in innovation sends two powerful messages. First, design is a differentiator. Apple again rules the roost, and design-focused companies—from Procter & Gamble to IDEO to BMW—are all on the rise. Need further proof? Just look at design-friendly retailers IKEA and Target, both new to the list.

The other message? Innovation is becoming ever more broadly defined. True product innovators have their place on our list—Nokia and newcomer Research In Motion come to mind. But respondents to the *BusinessWeek*-Boston Consulting Group survey value other kinds of innovators, too, from process masters, who remake the supply chain, logistics, or sales channels, to business model revolutionaries, who create brand-new ways of doing business. Take a look at who's up and who's down.

Methodology

The *BusinessWeek*-Boston Consulting Group 2006 senior management survey on innovation was distributed electronically to executives worldwide in early 2006. In February surveys were sent to the largest 1,500 global corporations, determined by market capitalization in U.S. dollars, with instructions to distribute the survey to their top 10 executives. The survey was also accessible on several Web sites: the BCG Innovation Institute, *BusinessWeek*, Knowledge@Wharton, and the *Nightly Business Report.* Survey participation was voluntary and anonymous, and the survey closed in April, 2006. The survey consisted of 19 general questions on innovation and an optional 8 questions that focused on innovation metrics.

A total of 1,070 executives answered the survey. Of those, 46% were from North America, 30% from Europe, and 16% from Asia or the Pacific region. To avoid vote-stuffing, respondents were asked to identify the most innovative company outside their own industry. For a full list of the top 100 companies, go online to businessweek.com/innovate.

▲ Process Innovation
■ Product Innovation
● Business Model Innovation

2006‡
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‡In the 2006 rankings, we broke ties by comparing 10-year annualized total shareholde
‡‡‡Annualized, Dec. 29, 1995 to Dec. 30, 2005, price appreciation and dividends.
Data: Analysis and data provided in collaboration with the innovation practice of The B

Companies

2006 survey and analysis of 1,070 senior executives in 63 countries by The Boston Consulting Group

	WHY	BEST PRACTICES	1995-2005 MARGIN GROWTH‡‡	1995-2005 STOCK RETURNS‡‡‡
	Hello, iPod World. Outstanding design and innovative software platforms create an unrivaled user experience.	■ ●	7.1%	24.6%
	Allows one of the world's brightest crops of engineers time to experiment. Focuses on simplicity and the customer.	■ ●	n/a**	n/a**
	Revamped its vaunted R&D labs in 2003 to centralize basic research. With new CEO George Buckley, an engineer is back at the helm.	■	3.4	11.2
	A master of manufacturing innovation, and now, hybrid technology. New cost-cutting strategy calls for reducing vehicle system costs as a whole.	▲ ■	10.7	11.8
ft	Primes Windows and Office sales with innovations. A new combo of Web and PC services, called Live, is off to a solid start.	■ ●	2.0	18.5
Electric	Transforming from an efficiency powerhouse to one that values bold ideas. Now rates managers on traits such as "imagination and courage."	▲ ■	5.7	13.4
& Gamble	Its "connect and develop" model calls for 50% of new products to come from outside. Design and innovation execs are now part of the org chart.	▲ ■ ●	4.4	12.6
	Global handset leader. Diverse teams create future-oriented "world maps" to track macro trends. Designed low-cost phones for emerging markets.	▲ ■ ●	0.0	34.6
ks	Would you like a movie with your latte? The creator of the $3 coffee has started marketing films. Taps an army of baristas for customer insight.	■ ●	2.2	27.6
	Donated 500 of its more than 40,000 patents to help build new technology ecosystems. Co-invests in projects with clients and partners.	▲ ■ ●	–0.7	14.4
	Adds its hip lifestyle brand to everything from airlines to insurance. Enters new businesses at lightning speed.	●	private	private
g	An intense design focus, speedy product cycles, and rigorous metrics make the South Korean company a creative force in electronics.	▲ ■	–4.5***	22.7
	Fell eight spots this year; is trying to claw its way back with a focus on high-def products and a revamped management structure.	■	–11.0	5.1
	Revolutionized the PC supply chain and sales channels. But stuck in Apple's shadow, Dell fell eight spots this year.	▲ ●	2.0	39.4
	Designed the Palm V and Leap chair. Now helps some of the biggest companies learn design thinking and transform their cultures.	▲ ■	private	private
	Brings teams together to collaborate inside an innovative research center. Sets up competitions between designers for new car models.	▲ ■	9.1	14.2
	Expanding beyond microprocessors and outside the PC. Poised to launch more products in 2006 than at any time in its history.	■ ●	–0.3	13.8
	Built the world's largest online marketplace and a new way of doing business. Launching a fixed-price site to cater to busy consumers.	●	13.0***	n/a**
	A focus on affordable design and a different retail experience have turned the Swedish retailer's shoppers into cult fans.	▲ ■ ●	private	private
t	Wields technology and pioneers processes to streamline its supply chain. A beleaguered image may have prompted its seven-spot fall.	▲	1.9	16.2
	Continuously focuses on improving the online experience. Ramping up R&D spending on search and Web services for outside merchants.	▲ ■	25.0***	n/a**
	Embraced design as a differentiator in the discount market. Creative marketing and temporary stores surprise devoted customers.	■ ●	7.4	25.2
	Known for excellent engineering, Honda is thinking outside the car, launching solar cell production for homes and businesses next year.	■	8.0	12.9
h In Motion	Breakthrough mobile devices changed the way business communicates. Dominates the wireless e-mail market.	■	57.0***	n/a**
est Airlines	Created the low-cost airline model through operational innovation. Developed fare marketing software for consumers' desktops.	▲ ●	-0.1	13.9
	Most Innovative Companies		3.4	14.3
	Standard & Poor's 1200 global stock index		0.4	11.1

ties between a public and a private company, the public company was favored. ‡‡Annualized from the 1995 to 2005 fiscal year earnings before interest and taxes as a percent of revenue. s tied with Hewlett-Packard for #21; Honda tied with Cisco Systems and DaimlerChrysler for #23. **Insufficient data ***Based on fewer than 10 years of data

ard & Poor's Compustat® data and company reports

turing processes. But thanks to the hot-selling Prius, Toyota is earning even more respect as a product innovator. It is also collaborating more closely with suppliers to generate innovation. Last year, Toyota launched its Value Innovation strategy. Rather than work with suppliers just to cut costs of individual parts, it is delving further back in the design process to find savings spanning entire vehicle systems.

The *BusinessWeek*-BCG survey is more than just a Who's Who list of innovators. It also focuses on the major obstacles to innovation that executives face today. While 72% of the senior executives in the survey named innovation as one of their top three priorities, almost half said they were dissatisfied with the returns on their investments in that area.

The No. 1 obstacle, according to our survey takers, is slow development times. Fast-changing consumer demands, global outsourcing, and open-source software make speed to ma paramount today. Yet companies often can't organize th selves to move faster, says George Stalk Jr., a senior vice-p dent with BCG who has studied time-based competition fo years. Fast cycle times require taking bets even when huge offs aren't a certainty. "Some organizations are nearly imm lized by the notion that [they] can't do anything unless it m the needle," says Stalk. In addition, he says, speed require ordination from the hub: "Fast innovators organize the co rate center to drive gro They don't wait for [it come up through the l ness units."

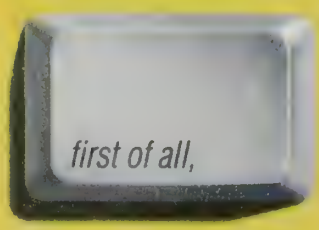
OPEN YOUR LABS AND EXPAND YOUR OPPORTUNITIES

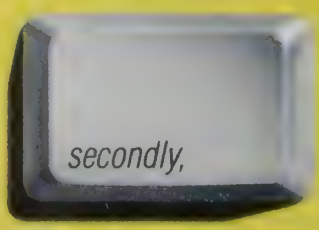
Corporate R&D labs are opening their doors—**collaborating with suppliers and customers, sharing software code with programmers, and tapping networks of scientists and entrepreneurs** for the world's best ideas

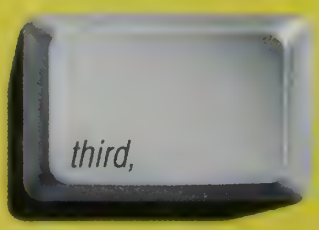
Indeed, a lack of coord tion is the second-big barrier to innovation, acc ing to the survey's findi But collaboration req much more than paying service to breaking dow los. The best innova reroute reporting lines create physical spaces for laboration. They team people from across the chart and link rewards t novation. Innovative co nies build innovation tures. "You have to be wi to get down into the plumbing of the organization and alig nervous system of the company," says James P. Andrew, heads the innovation practice at BCG.

Procter & Gamble Co. (No. 7) has done just that in tr forming its traditional in-house research and develop process into an open-source innovation strategy it calls " nect and develop." The new method? Embrace the colle brains of the world. Make it a goal that 50% of the compa new products come from outside P&G's labs. Tap network inventors, scientists, and suppliers for new products that ca developed in-house.

The radically different approach couldn't be shoehorned managers' existing responsibilities. Rather, P&G had to apart and restitch much of its research organization. It cre new job classifications, such as 70 worldwide "technolog trepreneurs," or TEs, who act as scouts, looking for the l breakthroughs from places such as university labs. TEs als velop "technology game boards" that map out where tech







eas from the Innovators

a page
n some of
world's
st respected
tive
panies:

Bring them together

BMW relocates between 200 and 300 engineers, designers, and managers to its central research and innovation center to design cars. **Face-to-face teams reduce late-stage conflicts and speed development times.**

Think traits as well as numbers

Tracking innovation results is crucial for any growth-focused company. **But when evaluating managers, subjective metrics, such as risk tolerance or GE's measure of "imagination and courage," can be a better way.**

Make a seat at the table

Infosys **selects nine employees under 30 each year to participate in its senior management sessions.** These young guns present their ideas for new services and ways to improve the company's processes.

Preserve oral traditions

Old-timers at 3M are expected to **hand down tales of the company's long innovation tradition** to new engineers. Before long, every new 3Mer can quote the philosophies of former CEO William McKnight.

Get involved on the ground

Research In Motion co-CEO Mike Lazaridis personally heads engineering teams and hosts weekly innovation-themed "vision" sessions to excite the troops. **A culture of innovation starts from the top.**

pportunities lie and help P&Gers get inside the minds of npetitors.

spearhead the connect-and-develop efforts, Larry Huston n the newly created role of vice-president for innovation nowledge. Each business unit, from household care to health, added a manager responsible for driving culchange around the new model. The managers communilirectly with Huston, who also oversees the technology preneurs and managers running the external innovation rks. "You want to have a coherent strategy across the oration," says Huston. "The ideas tend to be bigger when ave someone sitting at the center looking at the compagrowth goals."

KING THE RIGHT QUESTIONS

DINATING INNOVATION from the center is taken literalMW Group, No. 16 on the list. Each time BMW begins deng a car, the project team's members—some 200 to 300 rs from engineering, design, production, marketing, purng, and finance—are relocated from their scattered loca to the auto maker's Research and Innovation Center, FIZ, for up to three years. Such proximity helps speed up unications (and therefore car development) and encourace-to-face meetings that prevent late-stage conflicts be, say, marketing and engineering. In 2004 these teams beneeting in the center's new Project House, a unique structure that lets them work a short walk from the company's 8,000 researchers and developers and alongside life-size clay prototypes of the car in development.

For many companies, cross-functional collaborations last weeks or months, not years. Southwest recently gathered people from its in-flight, ground, maintenance, and dispatch operations. For six months they met for 10 hours a week, brainstorming ideas to address a broad issue: What are the highest-impact changes we can make to our aircraft operations?

The group presented 109 ideas to senior management, three of which involve sweeping operational changes. One solution

Diving Into Innovation

The Top 100: Who else made the list? The world's 100 most innovative companies, according to our respondents.

A Creativity Quiz: Test your knowledge of the top 25 companies and the results of the *BusinessWeek*-BCG survey.

Innovation Archives: We mine our best stories on how companies, from Apple to Philips, are meeting the challenge.

The Story Behind the Story: For a podcast interview with Department Editor Jena McGregor by Executive Editor John A. Byrne, go to businessweek.com/search/podcasting.htm

BusinessWeek online

http://www.businessweek.com/extras

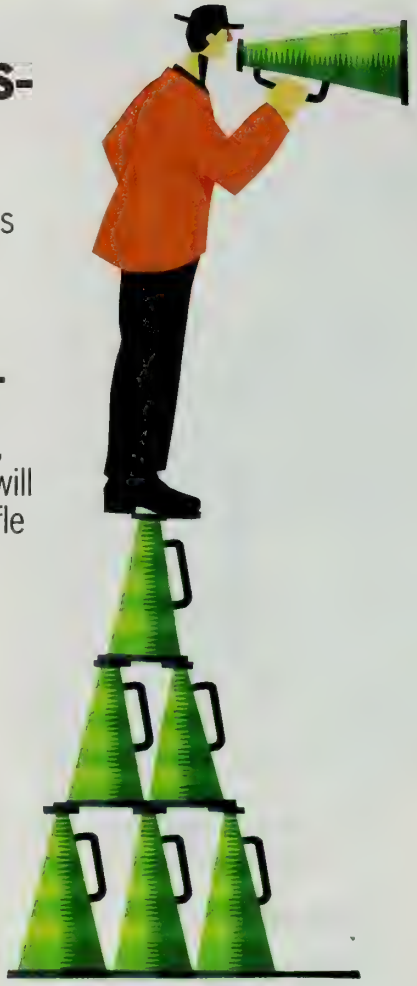
SHARE YOUR THOUGHTS.

Sun believes sharing is the way to create better ideas. That's why we've teamed up with *BusinessWeek* to offer you an opportunity to share your comments. Join the conversation about this week's Cover Story at businessweek.com/coverstory.

Sun microsystems share

BECOME INNOVATORS-IN-CHIEF

More than 50% of survey respondents said **the CEO or chairman was responsible for driving innovation.** Without heavy fire cover from the top, innovation efforts will get lost in the shuffle of short-term demands.



about to be introduced will reduce the number of aircraft "swaps"—disruptive events that occur when one aircraft has to be substituted for another during mechanical problems. Chief Information Officer Tom Nealon says the diversity of the people on the team was crucial, mentioning one director from the airline's schedule planning division in particular. "He had almost a naive perspective," says Nealon. "His questions were so fundamental they challenged the premises the maintenance and dispatch guys had worked on for the last 30 years."

Managers are scrambling to come up with ways to measure and raise the productivity of their innovation efforts. Yet the *BusinessWeek*-BCG survey shows widespread differences over which metrics—such as the ratio of products that succeed, or the ROI of innovation projects—should be used and how best to use them. Some two-thirds of the managers in the survey say metrics have the most impact in the selection of the right ideas to fund and develop. About half say they use metrics best in assessing the health of their company's innovation portfolio. But as many as 47% said measurements on the impact of innovation after products or services have been launched are used only sporadically.

Actually, most managers in the survey aren't monitoring many innovation metrics at all; 63% follow five gauges or fewer. "Two or three me just don't give you the visibility to get down to root cau says BCG's Andrew. Then there are companies that track fa many. Andrew says one of the top innovators on our list– mum as to which one—collects 85 different innovation me in one of its businesses. "That means they manage no them," he says. "They default to a couple, but they spend a mense amount of time and effort collecting those 85."

The sweet spot is somewhere between 8 and 12 metrics, Andrew. That's about the number that Samsung Electronic uses, says Chu Woosik, a senior vice-president at the Soutl rean company. Chu says the most important metrics are premiums and how quickly they can bring to market ph that delight customers. Samsung also watches the allocati investments across projects and its new-product success That, Chu says, has nearly doubled in the last five years. want to see it from every angle," he says. "A lot of comp fall into the trap that they thought things were really im ing, but in the end, it didn't work out that way. We don't to make that mistake."

AWARDS AND ETHNOGRAPHY

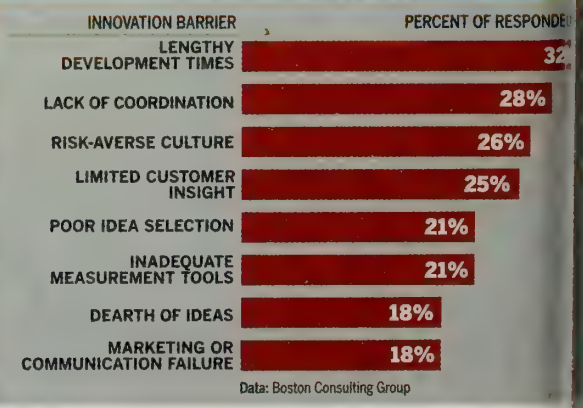
ONE OF THE BIGGEST MISTAKES companies may make ing managers' incentives too directly to specific innovation rics. Tuck's Govindarajan warns that linking pay too clos hard innovation measures may tempt managers to gam system. A metric such as the percentage of revenue from products, for instance, can lead to incremental brand exten rather than true breakthroughs. In addition, innovation is a murky process that targets are likely to change. "There's alogue that needs to happen," says Govindarajan. "Oper plans may need to be reviewed, or you may need to ch plans because a new competitor came into your space."

Susan Schuman, CEO of Stone Yamashita Partners, v works with CEOs on innovation and change, says that be numbers-driven metrics, some clients are adding subjecti sessments related to innovation, such as a manager's ris erance, to performance evaluations. "It's not just about res she says. "It's how did you lead people to get to those res

That's one reason the bastion of Six Sigma-dom, Ge Electric Co., has begun evaluating its top 5,000 manage "growth traits" that include innovation-oriented themes as "external focus" and "imagination and courage." G also added more flexibility into its traditionally rigid per

The Enemies of Innovation

Ideas are easy. The toughest obstacles, said our respondents, are developing speed and coordination



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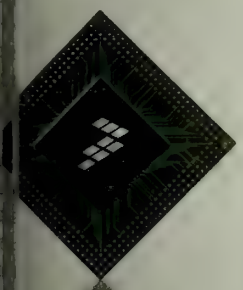

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ance rankings. GE will now have to square its traditional Six Sigma metrics, which are all about control, with its new emphasis on innovation, which is more about managing risk. That's a major change in culture.

How do you build an innovation culture? Try carrots. Several companies on our list have formal rewards for top innovators. Nokia Corp. inducts engineers with at least 10 patents into its "Club 10," recognizing them each year in a formal awards ceremony hosted by CEO Jorma Ollila.

3M has long awarded "Genesis Grants" to scientists who want to work on outside projects. Each year more than 60 researchers submit formal applications to a panel of 20 senior scientists who review the requests, just as a foundation would review academics' proposals. Twelve to 20 grants, ranging from $50,000 and $100,000 apiece, are awarded each year. The researchers can use the money to hire supplemental staff or acquire necessary equipment.

Of course, rewards won't help if the inventions aren't focused on customer needs. Getting good consumer insight is the fourth most cited obstacle to innovation in our survey. Blogs and online communities now make it easier to know what customers are thinking. Hiring designers and ethnographers who observe customers using products at work or at
helps, too. But finding that Holy Grail of
keting, the "unmet need" of a consum
mains elusive. "You need time, just thin
time, to step out of the day to day t
what's going on in the world and what
ing on with your customers," says Stor
mashita's Schuman.

MEASURE WHAT MATTERS

Tracking innovation results is hard: **You can't reduce it to a single number, and balancing risk is always part of the equation.** Just 30% of survey takers said they measure ROI on innovation investments.

THE WORLD IS YOUR LAB

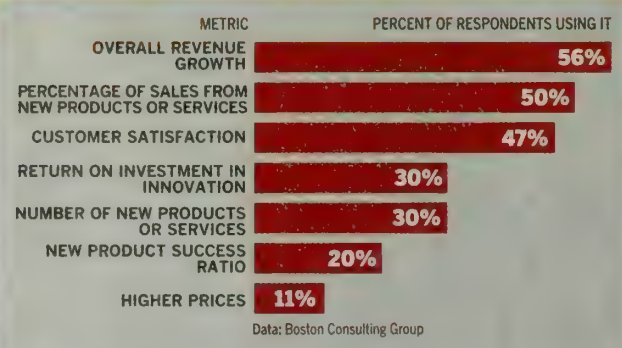
TRY LEARNING JOURNEYS. That's
Starbucks Corp., up 10 spots from 20
No. 9, does. While the coffee company b
doing ethnography back in 2002 and
on its army of baristas to share customer insights, it re
started taking product development and other cross-com
teams on "inspiration" field trips to view customers and t
Two months ago, Michelle Gass, Starbucks' senior vice-
dent for category management, took her team to Paris, D
dorf, and London to visit local Starbucks and other restau
to get a better sense of local cultures, behaviors, and fash
"You come back just full of different ideas and different w
think about things than you would had you read about i
magazine or e-mail," says Gass.

A close watch of customer insights can also bring innov
to even the most iconic and established products. Back in
3M began noticing and monitoring tw
sumer trends. One was troubling: Custo
were using laptops, cell phones, and B
Berrys to send quick memos or jot dow
of information. Every thumb-tapped
sage or stylus-penned note on a persona
ital assistant meant one less Post-it not

The other trend, however, was enco
ing: the rise of digital photography.
observing consumers, 3M researchers
to see their photos. What followed w
ways a clunky process: Consumers
scroll through screen upon screen of p
or have to dig through a drawer for th
shots they printed. Nine months later a
of one marketer and two lab scientis
upon the idea of Post-it Picture Paper, o
to paper coated with adhesive that lets p

Clear Facts for a Hazy Process

Companies frequently use overly broad methods to measure innovation success



Data: Boston Consulting Group

Autodesk
ea:
d a car that
es itself.
Realized:
Merge, accelerate, stop on a dime – all without taking your eyes off the op-ed page. Using Autodesk software solutions, designers model the car's self-steering system and manufacturers collaborate with civil engineers to synch the car with embedded road sensors. The result: software that lets your car do the driving, while you get on with more important things.
Software that simulates reality for ideas that are ahead of their time.
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COORDINATE AND COLLABORATE

There's no simple innovation "on" switch. **Building creative companies takes synchronization** from the center, cross-boundary collaboration, and structural changes to the org chart.

stick their photos to a wall for display. "We listened carefully to what consumers didn't say and observed what they did," says Jack Truong, vice-president of 3M's office supply division.

To get a sense of the value of customer research, imagine you're a Finnish engineer trying to design a phone for an illiterate customer on the Indian subcontinent. That's the problem Nokia faced when it began making low-cost phones for emerging markets. A combination of basic ethnographic and long-term user research in China, India, and Nepal helped Nokia understand how illiterate people live in a world full of numbers and letters. The result? A new "iconic" menu that lets illiterate customers navigate contact lists made up of images.

Other innovative ideas followed. By listening to customers in poorer countries, Nokia learned that phones had to be more durable, since they're often the most expensive item these customers will buy. To function in a tropical climate, it made the phones more moisture-resistant. It even used special screens that are more legible in bright sunlight.

Consumers increasingly are doing the innovation themselves. Consider Google Inc., our No. 2 innovator, and its mapping technology, which it opened to the public. This produced a myriad of "mash-ups" in which programmers combine Google's maps with anything from real estate listings to local poker game sites.

Google's mash-ups are just one example of the escalating phenomenon of open innovation. These days the world is your R&D lab. Customers are co-opting technology and morphing products into their own inventions. Many companies are scouting for outside ideas they can develop in-house, embracing the open-source movement, and joining up with suppliers or even competitors on big proj that will make them more efficient and more powerful. "W you work with outside parties, they bear some of the costs some of the risks, and can accelerate the time to market," Henry W. Chesbrough, the University of California at Berk Haas School of Business professor who helped establish concept with his 2003 book, *Open Innovation*.

India and China are growing sources of innovation for c panies, too. The *BusinessWeek*-BCG survey shows that the nearly as popular as Europe among innovation-focused ex tives. When asked where their company planned to incr R&D spending, 44% answered India, 44% said China, and said Western Europe. Managers tended to look to the U.S. Canada for idea generation, while a lower percentage look Europe for the same tasks. India and China, though, are seen as centers for product developn

Few companies have embraced open innovation model as widel IBM, No. 10 on our list. While the c pany's proprietary technology is s force to behold—Big Blue remains world's largest patent holder, with r than 40,000—the company is ope up its technology to developers, p ners, and clients. Last year it made of its patents, mainly for software c freely available to outside prog mers. And in November it helped the Open Invention Network, a con ny formed to acquire patents and them royalty-free to help promote open-source software movement.

Why the generosity? IBM believes that by helping to c technology ecosystems, it will benefit in the long run. "We to do things that encourage markets to grow," says Dr. Jol Kelly III, senior vice-president for technology and intelle property at IBM. By helping nurture those markets, says I "we know we'll get at least our fair share."

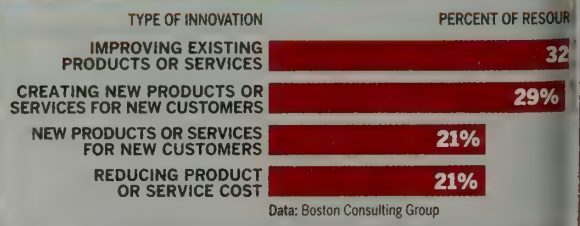
GOING OUTSIDE FOR IDEAS

P&G HAS HELPED ESTABLISH several outside networks novators it turns to for ideas the company can develop in-h These networks include NineSigma, which links up comp with scientists at university, government, and private YourEncore Inc., which connects retired scientists and neers with businesses; and yet2.com Inc., an online ma place for intellectual property.

Only a CEO can change a business culture at top speed in Alan G. Lafley, P&G has its own innovator-in-chief. Lafle in on all "upstream" R&D review meetings, 15 a year.

Where Innovation Resources Are Going

The largest share of time and money goes to incremental innovation, respondents say



Data: Boston Consulting Group

It's never too early to learn about energy efficiency.

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MINE CUSTOMER INSIGHTS

Getting inside **the minds of customers is essential for "aha!" moments that lead to innovation.** While ethnographers and designers are increasingly helping companies, true insight remains elusive: One quarter of our respondents still call customer awareness an innovation obstacle.

showcase new products. He also spends three full days a year with the company's Design Board, a group of outside designers who offer their perspective on upcoming P&G products. "He's sort of the chief innovation officer," says P&G's Huston. "He's very, very involved."

That sort of support from the CEO is essential, says Jon R. Katzenbach, co-founder of New York-based management consultancy Katzenbach Partners LLC. "The CEO determines the culture," he says. "If the CEO is determined to [improve] the surfacing of ideas and determined to make critical choices, then the chances of an [organization's] figuring that out are much, much greater."

Infosys Technologies Ltd., the Bangalore-based information technology services company that popped up at No. 10 on our Asia-Pacific list, takes a direct approach to making sure management stays involved in the innovation process. Chairman and "chief mentor" N.R. Narayana Murthy introduced the company's "voice of youth" program seven years ago. Each year the company selects nine top-performing young guns—each under 30—to participate in its eight yearly senior management council meetings, presenting and discussing their ideas with the top lea ship team. "We bel these young ideas the senior-most at tion for them to be i tified and fostered," Sanjay Purohit, asso vice-president and of corporate plann Infosys CEO Nanda Nilekani concurs: "I organization beco too hierarchical, i that bubble up younger people [a going to be heard]."

Mike Lazaridis, p dent and co-CEO of search In Motion, b an innovation-the invitation-only "Vi Series" session in Waterloo (Ont.)-b company's 100-seat ditorium each Thurs The standing-room-meetings focus on new research and future goals for the c pany that gave us the BlackBerry.

Lazaridis is likely the only chief executive of a publicly ed company who has an Academy Award for technical ach ment. (He won it in 1999 for an innovative bar-code reader he helped invent that expedites film editing and product He has donated $100 million of his own money to fund a t retical physics institute and an additional $50 million to a versity quantum computing and nanotechnology engine center in Waterloo. He has even appeared in an American press commercial, scratching complex equations across a b board while proclaiming his commitment to the cre process. "I think we have a culture of innovation here, and gineers] have absolute access to me," says Lazaridis. "I l life that tries to promote innovation." As the *BusinessWeek* survey demonstrates, it is a life every manager aroun world must embrace. ■

–With Michael Arndt and Robert Berner in Chi Ian Rowley and Kenji Hall in Tokyo, Gail Edmon in Frankfurt, Steve Hamm in Rome, Moon Ihlwan in S and Andy Reinhardt in

A Global Pulse of Innovation

Apple and Google reign worldwide. But respondents from different regions often favored local companies.*

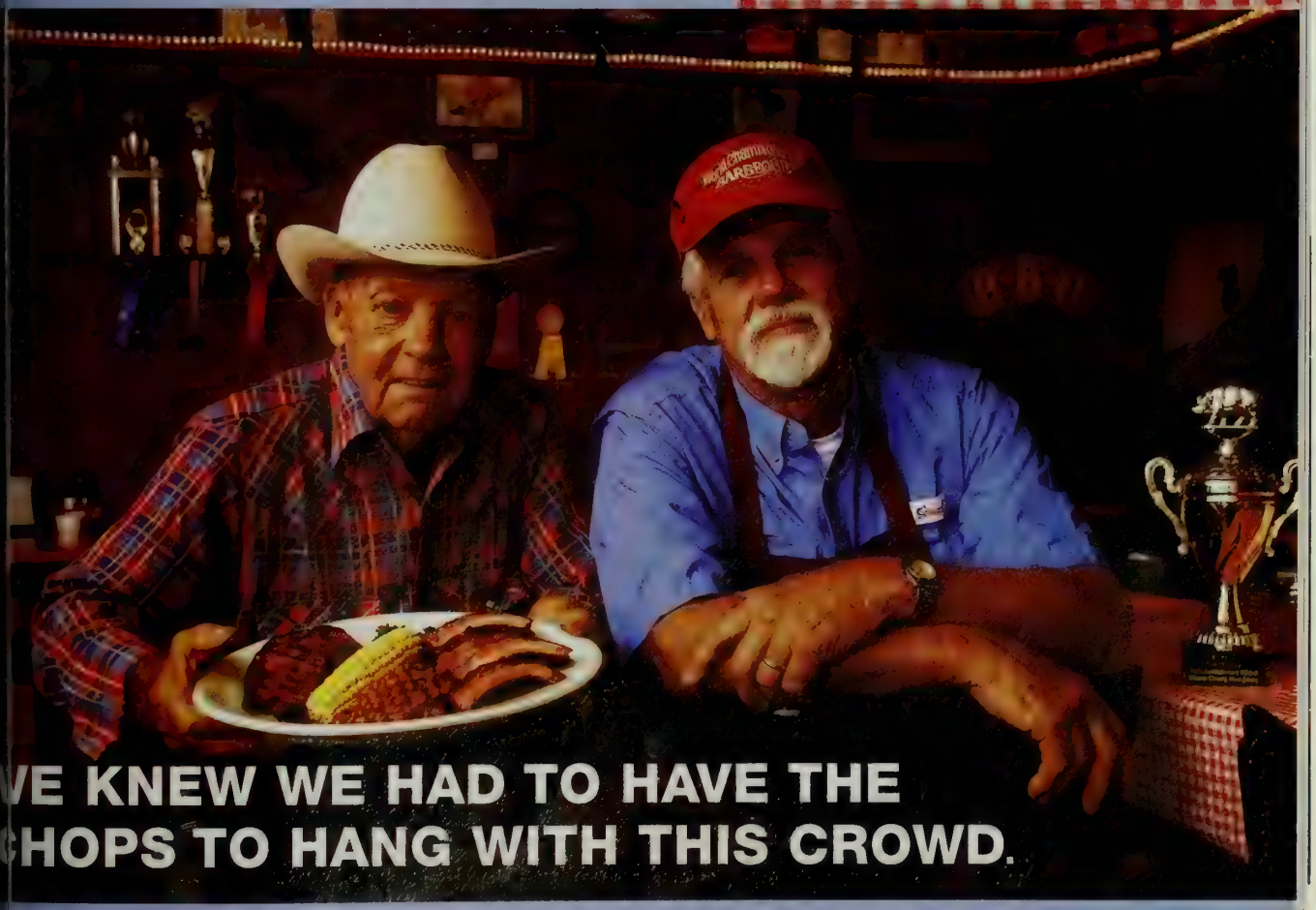
ASIA-PACIFIC		EUROPE		NORTH AMERICA	
1 Apple	9 Nokia	1 Apple	9 GE	1 Apple	9 IBM
2 Google	10 Infosys	2 Google	10 eBay	2 Google	10 Dell
3 3M	11 Virgin	3 Nokia	11 IKEA	3 P&G	11 Wal-Mart
4 Samsung	12 P&G	4 Microsoft	12 RyanAir	4 3M	12 IDEO
5 Microsoft	13 Dell	5 3M	13 Sony	5 Toyota	13 Target
6 IBM	14 Sony	6 Toyota	14 Intel	6 GE	14 Samsung
7 GE	15 Intel	7 Virgin	15 Porsche	7 Starbucks	15 Southwest
8 Toyota		8 BMW		8 Microsoft	

Data: Boston Consulting Group *We broke ties by comparing 10-year annualized total shareholder returns. In ties between a public and a private company, the public company was favored.

> > >

me folks barbeque for fun. Others do it for a living. mething they all share are tough standards for the ribs, rk shoulders and boneless loins they use. Cargill rned from chefs and grocers that people want more vorful pork that cooks up tender and juicy. We veloped it using special feeds, growing processes and ection techniques. Barbeque enthusiasts say they like new pork. What they won't tell us are their secrets cooking it. This is how Cargill works with customers.

ollaborate > create > succeed



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PROFIT MARGINS

CREATIVITY PAYS. HERE'S HOW MUCH

BY DAVID HENRY

So you're one of the 25 Most Innovative Companies in the world, but what about the bottom line? Does innovation really deliver? You bet. More than half of the Top 25 with histories as public companies scored big, with better profit margins and higher stock prices over the past decade.

How big? The innovators achieved median profit margin growth of 3.4% a year since 1995, compared with 0.4% for the median Standard & Poor's Global 1200 company. That's a huge achievement, thanks in large part to innovation. And the group's median annual stock return of 14.3% was a full three points better than the S&P 1200 median over the decade, according to a study done for *BusinessWeek* by The Boston Consulting Group using data from Standard & Poor's Compustat.

"Innovation is allowing companies to grow faster [and] have a richer product mix," says James P. Andrew, who heads BCG's innovation practice. Many companies could use the encouragement to push for it: Some 48% of businesses surveyed by BCG said they were dissatisfied with their returns on investment from innovation.

Target, Starbucks, Procter & Gamble, and Microsoft especially stand out for raising their profit margins and being rewarded by the stock market. Target Stores Inc.'s operating margin (earnings before interest and taxes as a percentage of revenues) doubled over the 10-year period, reflecting the discount retailer's skill in positioning itself as a hip alternative to Wal-Mart Stores Inc. with designer brands such as Isaac Mizrahi apparel and Michael Graves housewares. Target's stock performance was half again better than Wal-Mart's, another top innovator.

Starbucks Corp. presses for new ways to sell more than caffeine from its coffee shops. Its operating margin is up to 11.1%, from 9.1% in 2002, a level that had been fairly steady for the previous seven years. Starbucks shares delivered total returns of some 28% a year, nearly three times the S&P 1200's median of 11.1%. Procter & Gamble Co. shifted its product portfolio to higher-margin beauty and health-care businesses. Its operating margins are up to 19.3%, from 12.5%.

Microsoft Corp.'s profit margins rose to nearly 41.8%, from 34.3% in 1995. Its critics would attribute the gain to Microsoft's monopoly-like power. But the company does direct substantial R&D toward enhancing software. The effort makes its upgrades more compelling and helps protect its fat margins. One example: ClearType, which produces higher resolution of text in Windows XP.

Of course, innovation does not always deliver products and profits in a steady stream. Consider Apple Computer Corp. Even in its darkest money-losing days of the mid-1990s, it was the innovation leader in the computer industry. But only after co-founder and CEO Steven P. Jobs returned in 1997 and focused Apple's scattered efforts on key products did the company begin t prosper. In fact, Apple lost money three times in the past decade, including in fis 2001, which ended the month before Job unveiled the first iPod. Last year, Apple posted operating margins of 11.8%, near double the 6% of 1995.

Sony Corp. shows a different picture. Its in the innovation rankings in '06 may reflec eroding margins. Sony's operating margins have steadily declined from 7.7% in 1998 to 1.6% in 2005. And its stock has limped alor returning just 5.1% annually over 10 years.

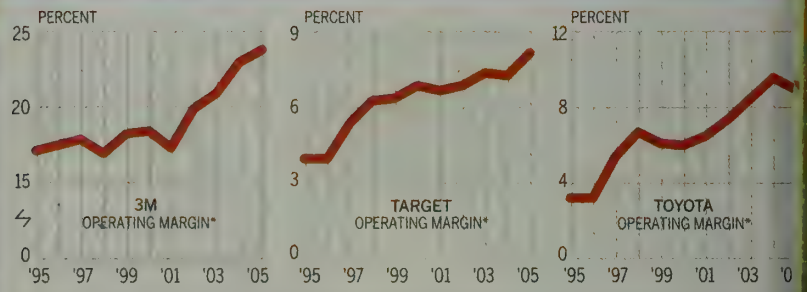
Sometimes the fruits of innovation are hidden by other factors. At Samsung Electronics Ltd., operating margins tend t oscillate between 21% and 7% with the up and downs of the semiconductor cycle. Samsung's latest reported margins, 14.3% are two-thirds of 1995's. Yet the company has made innovation key in its drive to cu development time and improve value for customers. That's one reason Samsung s makes good money even when industry growth slows. Samsung Electronics' shar have returned an annualized 22.7% for th last 10 years, according to BCG.

IBM, too, has continued to be a strong innovator over the last decade even as its operating margins have remained essenti flat. The company produces more patents than any other company in the world, com up with new chip designs, semiconductor manufacturing processes, and computer design. IBM has aggressively used innova to stabilize its margins in the face of price-cutting competitors, such as Dell Inc.

Even when the benefits of innovation clearly reach the bottom line, it may take a while for gains to benefit stockholders. 3M Co. and Toyota Motor Corp., for examp have delivered perhaps the most consiste improvements in operating margins, yet their stocks have been mediocre. Maybe it's time for the stock market to reward their innovation.

The Innovation Payoff

These innovators have racked up steadily higher profit margins



Data: Boston Consulting Group, Standard & Poor's Compustat *FISCAL YEAR EARNINGS BEFORE INTEREST AND TAXES AS PERCENT OF REVENUE

A MILE AHEAD

Innovators have seen median profit margin growth of 3.4% a year since 1995. Among S&P Global 1200 companies, the figure is only 0.4%.

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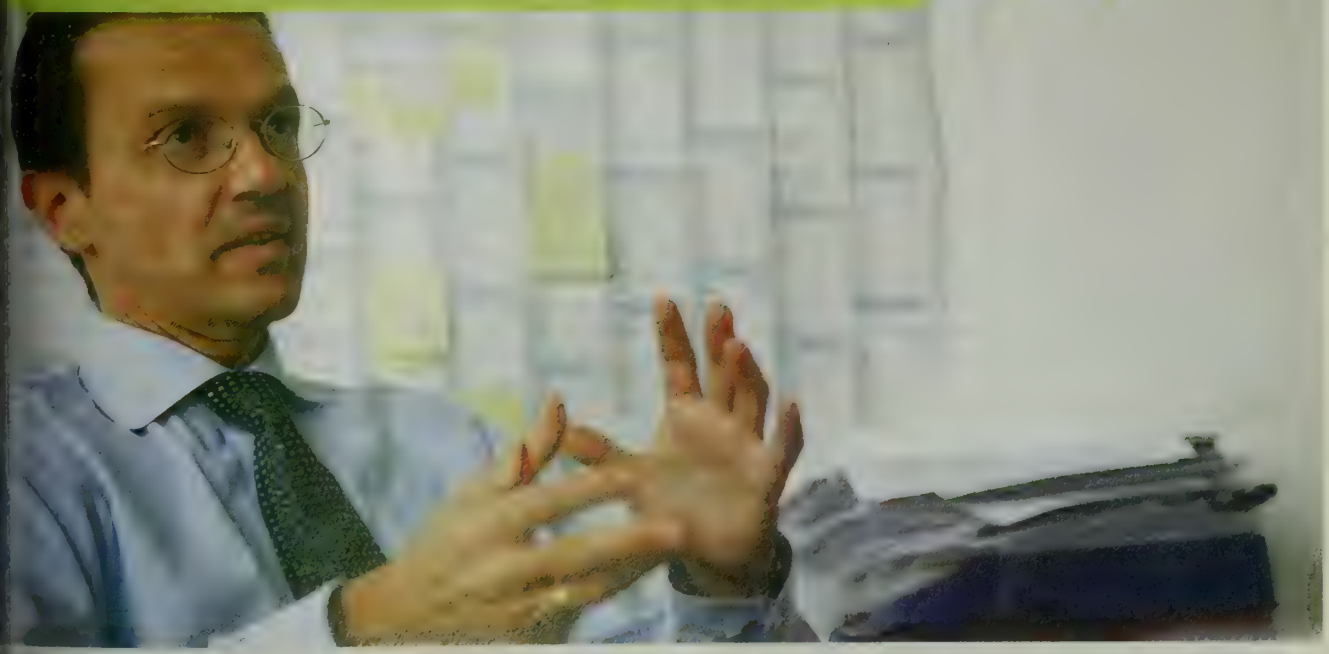

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Eyes Wide Open

Cephalon's careful marketing of its narcolepsy drug could serve as a manual for turning new ideas into hit products

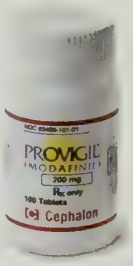
BY ARLENE WEINTRAUB

ENTREPRENEUR FRANK Baldino Jr. can still picture the mice that sparked the idea for his blockbuster drug back in 1992. Baldino, CEO of Cephalon Inc., was touring the animal lab at Lafon, a Paris drugmaker that was testing a new antidepressant. Rodents are nocturnal, so Baldino was stunned to see Lafon's mice wide awake in the middle of the day. He decided to license the compound and test it against drowsiness. "No one had developed a drug for wakefulness," he says. "We would have to create the market."

With the resulting drug, called Provigil, Cephalon has done more than create a market. Baldino's management strategy at each point in the drug's life cycle could serve as a manual for other biotechs seeking to turn radical ideas into hit products. Provigil, approved to treat narcolepsy and other causes of drowsiness, enhances alertness with little of the heart racing or hand shaking associated with caffeine. It has turned Cephalon into a shooting star: Revenues in 2005 hit $1.2 billion, up 19% from 2004, and Provigil accounted for about half of the haul. Profits jumped 14%, to $167 million, excluding one-time costs.

At the same time, Baldino has had to steer Cephalon through a minefield, petitioning the Food & Drug Administration to expand the list of legitimate uses for Provigil, while managing regulators' fears that the drug could become a lifestyle elixir for sleep-deprived people. In late March, the Frazer (Pa.) company hit a land mine. An FDA advisory panel declined to recommend a version of Provigil to treat children with attention deficit hyperactivity disorder, causing the stock to plunge.

It's always risky to tinker with the brain, the most complex organ in the body. Our states of mind are swayed by a million factors, past and present, biological and social. That makes it tough to predict the impact chemicals will have on each individual. History is littered with examples of mind-altering drugs—antidepressants, antipsychotics, and sleep aids—that failed to win the FDA's blessing or showed worrisome side effects later. Yet Cephalon has maintained its equilibrium. In the next few weeks, the FDA should rule on two Cephalon drugs: one to treat addiction, and the other a long-acting version of Provigil. A green light could push revenues up 25% this year, to $1.5 billion, and profits up 38% to $229 million.



In trials, Provigil kept pilots awake for up to three days

When Cephalon first licensed Provigil for an undisclosed sum in 1992, its vival was anything but guaranteed board worried that Cephalon would right through the $108 million it raised. Board member and inv William P. Egan, a founding invest FedEx Corp., scolded Baldino dur meeting. "He said: 'I don't know h spell DNA, but I know how to make ey, and you're not doing it,'" r Baldino, a PhD pharmacologist started his career at DuPont.

Scrambling for ways to get cash- sales experience—Baldino persu Bristol-Myers Squibb Co. to co-market a migraine me tion. This arrangement netting Cephalon $4.7 mill year when it ended in 199 the time Provigil was approv December of that Cephalon's salespeople formed close ties with neu gists who would be the drug's adopters. Cephalon sold $25.4 m worth of Provigil in its first year. time when no one believed in Cepha Egan recalls, "we proved that we build a focused sales force."

Baldino's business model has ev as its workforce has grown from an four employees to 3,000. To stay preneurial, Baldino granted full ma ment power to the heads of each Some of them then made d changes: The sales and marketing

PLAYBOOK

Rx for Drugmakers

Cephalon's handling of wakefulness drug Provigil is a wake-up call to biotechs:

KEEP YOUR OPTIONS OPEN

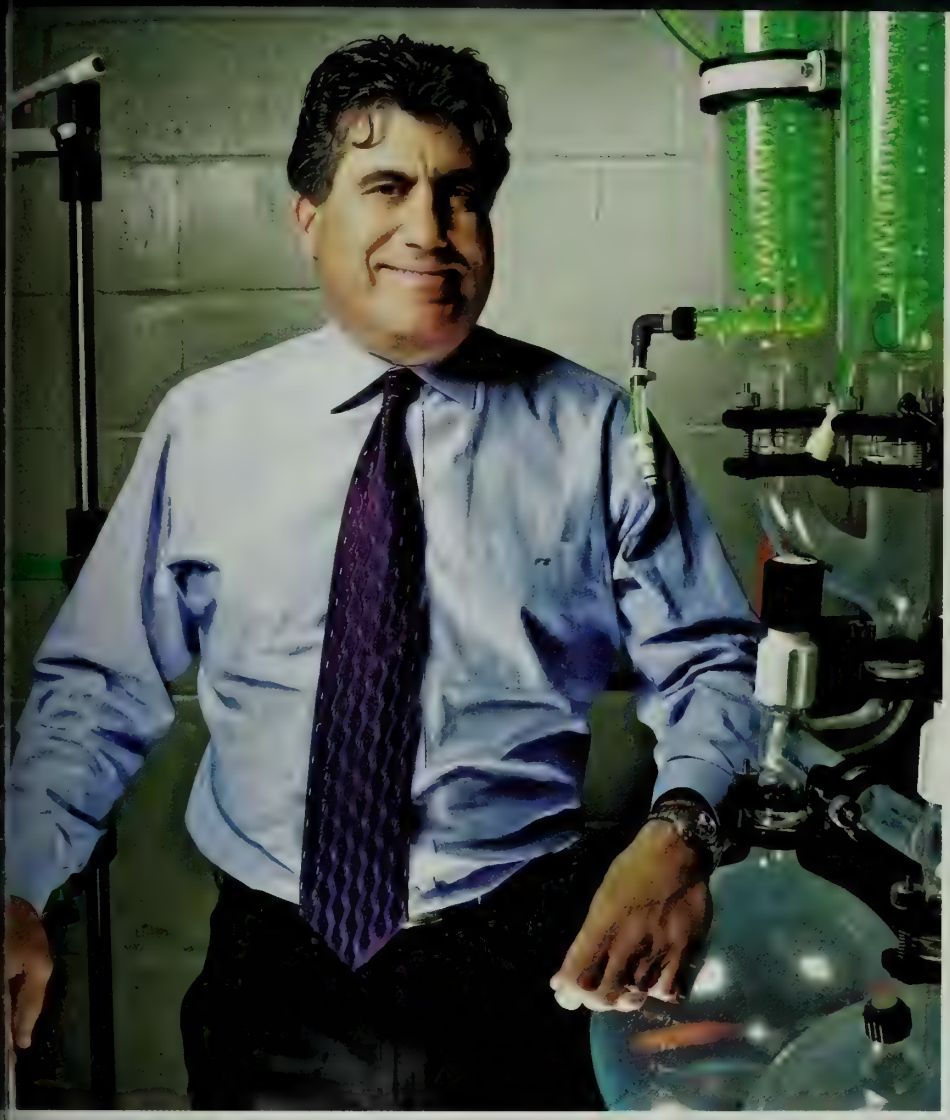
ACTION Cephalon pours 27% of its revenues into R&D—two to three times the average for Big Pharma companies.

RESULT Working on several drugs at once helps shield Cephalon from disappointments. The FDA is currently reviewing four new Cephalon drugs.

LEARN FROM CUSTOMERS

ACTION Cephalon scier respond to doctors who that Provigil is helpful w disorders, such as sleep

RESULT Collaborating v doctors, Cephalon can FDA with persuasive data on these and thus expand the use of the drug



BALDINO Sales of Provigil are expected to double, to $1 billion, by 2010

ent team gave field reps the freedom on all the physicians in their geo- ic territories and to sell them all of lon's drugs, including treatments in and epileptic seizures. It was a lete switch from the early days, each rep sold one drug to certain lists. Revenues grew tenfold in the ars following the restructuring.

n as Baldino's strategy started to pay wever, risks were becoming evident. 24/7 world, alertness is a precious odity, and Provigil seemed to invite abuse. The compound is not addictive, does not give users an amphetamine-like buzz, and isn't classified as a controlled substance. So thousands sought it out as a "safe" stimulant. The FDA seemed to feel that Cephalon was encouraging them. In 2002 its promotional brochures drew a rebuke from regulators, and in late 2004 the U.S. Attorney's office in Philadelphia initiated a probe of Cephalon's sales practices.

Yet Baldino and his staff understood there was nothing wrong with doctors prescribing drugs for different ailments. The FDA bars companies from promoting drugs for any condition other than those approved on the label, but it doesn't object to doctors experimenting on their own. With Provigil, physicians were eager to do so. They may not know exactly how the drug works, but it clearly affects the regions of the brain responsible for wakeful states. In trials, pilots who took Provigil stayed awake for three days. Doctors have thus prescribed it for everything from chronic fatigue syndrome, to heart failure symptoms, to sleepiness with no apparent cause. Some 50% of sales now come from such legal, "off-label" use.

Baldino is learning how to steward this immensely popular drug without incensing the FDA. Company policy dictates that when doctors come to sales reps with glowing reports on how the drug performs in one or another treatment area, reps are forbidden to use the information to fan sales. Instead, doctors are instructed to call the company's scientists. This often leads to research collaborations and new trials, which have helped win the FDA's blessing to market Provigil to people who work night shifts, for example, and to patients with sleep apnea, a condition that disrupts sleep. "We're following the regulations, and as they evolve, we will evolve," Baldino explains.

Because brain science is still young, snafus happen. Witness the travails of Sanofi-Aventis, maker of Ambien, a popular sleep aid. In March, bizarre reports emerged of people taking the drug and then driving or eating in their sleep. In one case, a woman sleepwalked to the kitchen and scarfed down an entire bag of hamburger buns slathered with butter.

In light of such incidents, the FDA could require other companies to disclose more details about side effects on drug labels, and dictate how they should track adverse events after approval. That could complicate Cephalon's efforts to get Provigil approved in new areas such as Parkinson's disease and cancer. "These concerns have to be watched," says Dr. Karen R. Ballaban-Gil, associate director of the Montefiore Medical Center Sleep-Wake Disorders Center in New York.

As for Cephalon's March stumble in ADHD, Baldino refuses to give up on what could be a $3 billion opportunity. The FDA's advisory panel feared the drug called Sparlon—a version of Provigil—was responsible for dire skin rashes. But Baldino doesn't believe Provigil is to blame for the severity of the rashes, and hopes to press his case with the FDA. "The ball's in our court," he says.

REPRENEURIAL

ACTION Cephalon CEO Baldino gave decision-making power to the heads of each unit.

RESULT The sales unit gave reps the freedom to call on all the physicians in their geographic rather than just certain specialists, ducing a bump-up in sales.

Gimme Shelter, and Make It Snappy

How NASCAR helped Allied boost sales of its low-cost warehouses and garages

BY COLEMAN COWAN

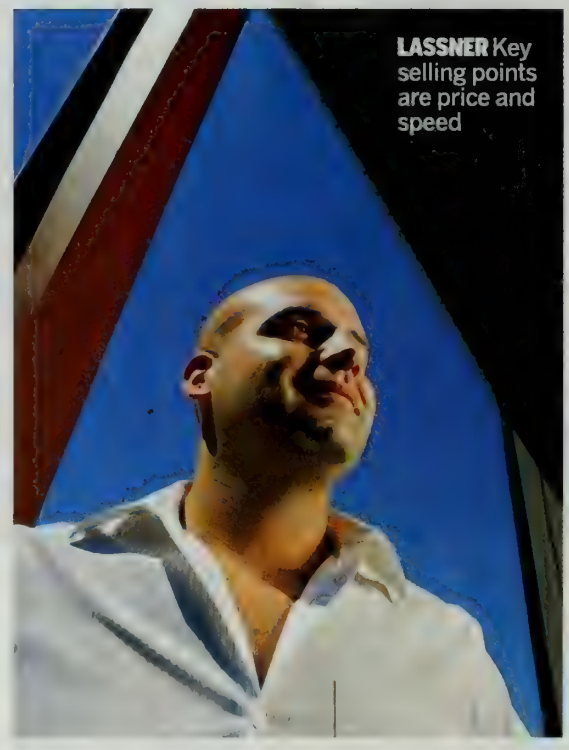
SPLASHING A LOGO ON the hood of a NASCAR racer is something big companies have been doing for years. But the rear panels of driver Dave Blaney's car show off the blue-and-black logo of Allied Steel Buildings, a 36-employee Fort Lauderdale outfit most race fans have never heard of. This year, Allied will be an associate sponsor for Blaney and his teammates, paying $1.4 million to get its name on vehicles in several NASCAR circuits.

That's a hefty spend for a business barely three years old, but that gambit, along with other creative tactics, have helped transform Allied from a small player into a national brand. In August, the first month of Allied's sponsorship, sales rose 40%. Revenues jumped to $32.5 million in 2005, up from $15.7 million in 2004.

Not bad for a company that was started on the fly. Michael Lassner, 32, and Charles Kowalski, 43, were salesmen for a steel-buildings company when, in March, 2003, they received one day's notice that it was going under. "The worst thing at that moment happened to us, but it became the best thing," says Lassner. Their former employer, says Kowalski, "could not see what we could see."

Kowalski and Lassner envisioned the market for steel buildings extending beyond the garages and warehouses that are the mainstay of the $3 billion industry. As Lassner says, they wanted "a steel building on every corner"—large warehouses, retail stores, power plants, and churches.

To make buying a steel building easier, Lassner and Kowalski became a one-stop shop, handling design, order, and delivery of steel, permits, and even finding contractors to assemble the buildings.



LASSNER Key selling points are price and speed

BUSINESSWEEK SmallBiz

Just 30 days after their old company folded, the duo had launched Allied Steel with $27,000 in savings. Lassner and Kowalski describe themselves as a white-collar/blue-collar team. "Mike wears the suit and tie, and I wear the work boots," says Kowalski, a gregarious former roofer who handles sales and design. Lassner, who previously worked at an Internet startup developing video technology, tackles marketing and operations.

They began with a large but targeted promotional effort, placing ads in business sections of newspapers ra than relying on classifieds. They also vertised on billboards and radio launched a direct-mail campaign. 2005, their ad budget was $2 millio

Price and speed are their strongest selling points. So-called engineered buildings run about 50% than traditional construction. A tw garage from Allied costs about $5,0 recent contract for an electricity p came in at $170,000, and the compa average sale is $30,000. Dennis St man, pastor of the First Baptist Ch in Burley, Idaho, bought an Allied b ing in 2003 as his congregation's church. "[It] was delivered on time, it went up very quic Stoneman says. The chur fronted by a wooden e giving it a traditional loo

Lassner hopes to bes competitors through sup customer service. Gene that means getting per faster and buildings d ered on time. But in 2 when spiking deman China sent steel prices bling, customer service denly meant being abl withstand global su shocks. The partners sc bled to rework $3 milli outstanding contracts, e as much of the increa they could. "When we di math, we knew we wou broke, but we would have our company and tomers," says Lassner. A lied grows, he's better al negotiate better prices his two main suppliers cor and Star Buildings.

To sustain that growth, the par are searching for new ways to reac tomers, becoming the first in their i try to sell through hardware stores year, Allied began putting its displ 360 Canadian building-supply s trying to appeal to homeowners small contractors. This spring, Allie place its software in about 20 stores owned by national hardware 84 Lumber, allowing shop clerks to out price quotes and preliminary That's just one more way Lassne Kowalski hope to benefit by thinkin side the steel box. ■

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Winning Back Joe Corkscrew

Mouton Cadet is making over its famous Bordeaux to take on more popular wines

BY DAVID KILEY

BEFORE THERE WAS YELlow Tail, the ubiquitous brand of Australian wine that has invaded the U.S. like rapidly multiplying wallabies, there was Mouton Cadet from Bordeaux.

Since its launch by Baron Philippe de Rothschild in 1931 as the first branded premium wine priced for the middle class, Mouton Cadet has been the gateway wine for drinkers discovering Bordeaux. By 2002 it was selling 15 million bottles a year worldwide. But lately it has been collapsing in the U.S. Casual wine drinkers have been attracted to fruitier and better-marketed wines from Australia and South America. And retailers, for a brief time, cooled to featuring overtly French wines, considering the wave of anti-Gallic feeling that began in 2003 when France opposed the Iraq war. Rothschild sold only 2.9 million bottles in the U.S. in 2004, less than half its 6.5 million high in 1992, according to the annual study by wine and spirits research journal *Impact*.

Now the house of Rothschild is trying to reclaim its place in America as a trusted, sophisticated budget brand. It's designing blends that taste more like Napa and Aussie wines, recasting its labels, and wielding new distribution muscle through an alliance with Constellation Brands Inc. It also hopes to capitalize on buzz that 2005 may be Bordeaux's best year in a quarter-century. The trick for Rothschild will be to avoid dumbing down Mouton Cadet's esteemed product as it tries to modernize. That balance isn't easy to strike when success today derives as much from the label as from the wine.

When it comes to marketing, most French vintners move like *escargots*. But Xavier de Eizaguirre, president of the management board of Baron Philippe de Rothschild, has become a realist. Besides bending to the rounder flavors of upstarts lately more successful than Bordeaux, he is talking about such once-noxious notions as screwcaps and wine boxes. "France remains a reference for the world. But when it comes to marketing and packaging, we need to clean up our act," concedes Eizaguirre.

The attempt at restoration, fittingly, began with the wine, starting with the 2003 vintage. Priced at $6 to $8, Mouton Cadet rouge went from an oak-finished cabernet sauvignon-dominant wine to one that's unoaked and 65% merlot. The result is a fruitier, less tannic wine created in direct response to Australian and Spanish reds. The white wine

ILLUSTRATION BY STEPHEN WEBSTER

March of the Pinots

Lately it seems as if wine is going to the dogs—not to mention the monkeys, penguins, and kangaroos. Almost 20% of wines introduced in the past three years feature animals on their labels, according to ACNielsen. With names like Little Penguin, Monkey Bay, and Funky Llama, "critter brands" outsell noncritter counterparts 2 to 1, ACNielsen says. The trend started in 2001 with Australia's Yellow Tail, featuring a wallaby, which quickly hopped to the top U.S. import spot. A recent addition is French rabbit, a line with eco-friendly packaging.

-Amy Cortese

ıore sauvignon blanc the old blend and a r profile as well. child also uncluttered el and tried to demys- e wine by putting the ıtages of each grape back. And despite a euro, Rothschild has J.S. prices low.

n so, critics aren't ed and say the vint- haven't gone far h. "I'd be more en- stic if they put 'merlot' on the front dropped Mouton Cadet, and re- l it Smackamucko or something," skeptical Gary Vaynerchuk, owner Wine Library in Springfield, N.J., inelibrary.com.

en all the competition, though, the k for most high-volume wine from e remains bleak. That's why the ry's top wine and spirits company, d Ricard, passed up a chance to ute Mouton Cadet and has no h wines at all, other than Cham- , in its portfolio. "The French mar- so fragmented, and there is such ersupply of wine, that we don't see rofit," says Pernod Deputy CEO Pringuet.

The recent Rothschild offerings are fruitier, fuller, and less tannic

BACKLASH

TELLATION HAD no French wines until it agreed to distribute Mou- det. Rothschild had impressed the ny by doing some consumer re- of its own. "They listened to con- s, which was refreshing, especially g from a French company," says Joseph, vice-president for con- research at Constellation.

hschild's research meshed with ellation's: American consumers elieve the best wines in the world from France, even though they drinking them as much. "That it 40,000 cases with zero marketing 2000 smells like opportunity to us," ethany DiSanto, marketing chief at ellation's North Lake Wines unit.

eed, Constellation has been ogling ccess of French wines marketed ac- g to the new school. E. & J. Gallo y's Red Bicyclette is essentially a n jug wine, successfully branded by ing a cartoon of a Frenchman in a riding a red bike with a dog follow- hind him. The friendly label over- the brief backlash against French And Fat Bastard wines, from south- ance, is a marketing phenomenon, 425,000 cases in the U.S. last year.

Since Eizaguirre isn't prepared to go the funky label route, Constellation is navigating a busy boulevard of French restraint and consumer targeting. The company has identified four kinds of buyers it must reach to make headway: the enthusiast (passionate and attentive to ratings), the image seeker (buys premium wine as a rule), the satisfied sipper (always buys the same stuff, e.g., merlot), and the traditionalist (likes familiar labels). The job would be easier, DiSanto concedes, if Rothschild had upped the merlot enough to flag the popular varietal on the front label. As is, buyers who don't read the back see only the information that it's a red Bordeaux—along with a brief poem in French.

Rothschild and Constellation are putting just $1 million into promoting Mouton Cadet anew this year, mostly giving retailers advertising support to feature it. In addition, the company is prowling affordable U.S. equivalents of the niche sponsorships that it has recently taken in Europe—the Cannes Film Festival and the Old Vic Theatre in London. Given Americans' liking for critters on labels, though, they might want to consider partnering with something like the Westminster Kennel Club Dog Show. ■

BusinessWeek online For BW's ratings of Mouton Cadet and some of its rivals, go to www.businessweek.com/extras

To see a taste test of the wines that are beating out Bordeaux, watch *BusinessWeek Weekend*. Check your local TV listings or go to businessweekweekend.com

HEDGING BETS

The Chilean Connection

Despite what many wine experts say will be a phenomenal 2005 vintage in Bordeaux, the region's marketing challenges may be summed up by top wine critic Robert Parker. "One of the great wines I tasted in Bordeaux," he wrote recently after sampling some 2005s, "was from Chile...the 2003 Almaviva."

Ouch. But it turns out that Almaviva, created through a joint venture between Baron Philippe de Rothschild and Viña Concha y Toro, priced around $60, is one of the French wine producer's Chilean successes. Another is Escudo Rojo, a $12 blend of cabernet sauvignon, cabernet franc, syrah, and the Chilean native grape carmenère that generally scores well among wine ratings.

The French have long tinkered in Chile, attracted to the cheap land, the climate, and the soil—*terroir*—that remind them of home. And they have long appreciated a natural barrier, the Andes Mountains, to phylloxera, a plague of vine lice that periodically wipes out the roots of vineyards in Europe. Now the New World terrain has become a sort of hedge for Rothschild against weak sales of its Old World Bordeaux. In fact, Escudo Rojo ("red shield," or Rothschild, in Spanish) sold about 100,000 cases last year, about 12,000 in the U.S., with scant marketing. Xavier de Eizaguirre, president of Rothschild's management board, sees potential sales of 250,000 cases worldwide and 100,000 in the U.S., especially with Constellation Brands Inc. behind the label. That could certainly put a dent in the 300,000 cases a year of lost Mouton Cadet sales in the U.S. since 1992.

At 5.8 million cases of wine sold in the U.S. in 2004, Chilean wines are off their high from 1998, according to wine and spirits journal *Impact*, but they're gaining overall since they first showed up in volume on U.S. shelves in the late 1980s. "We view Chile as one of the hottest growth markets ripe for new marketing and more sophisticated assemblages [of grapes]," says Eizaguirre. Indeed, even casual wine enthusiasts eagerly seek new discoveries from Chile, much the way they used to feel about the output of Bordeaux.

–David Kiley

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Captive INSURANCE

A BETTER MOUSETRAP

:ernative Risk Transfer ɜkes over the world.

ɜative Risk Transfer (ART) is the name given to forms ɪurance not so long ago considered alternative to the onal model. The ART label has stuck, even though than half of U.S. domestic insurance last year was ɜured using "alternative" techniques. The dominant ɪe in the arsenal of ART is the captive insurance ɔany.

s sexy than, say, hedge funds, the flowering of ve insurance in the past 40 years was nonetheless ɪl to the forward motion of the financial markets. ts benefits now attracting worldwide interest, the f captive insurance is very much on the agenda in -suite.

ɔtive insurance is self-insurance. In its purest form, a ve insures only the risks of its parent, but variations flourished that insure risks of associated parties, as hospitals or attorneys. Other types of captive sed for particular, closely defined risks. A range of ies has been created, with curious names like "rent- ɔtive" and "cell companies" (segregated cells, not hones), to allow access to the captive market to an ɔroader range of economic interests.

e insurance is a by-product of our dence on oil and the structure and of the energy industry. Insurance ans date the earliest captive ɪny to no ɔan 1922. founded in sey, one of annel Islands e U.K. In the rs following, lful of mutual nsurance anies rmed Eopean- . transnational oil and petrochemical anies, which were considerably larger al enterprises than were the major s of the day. Then, too, the big energy anies, comfortable with the notion of ɔorder business, understood their cated risks better than insurers could. t result, initially, was lower insurance ums for the captives' owners. y other advantages have since emerged. Captives can offer lower insurance costs, cash flow advantages, risk management control, and access to reinsurance. The larger captives act as independent insurance companies, writing third-party business. Tax may be minimized, but is no longer the driver in captive formation; the sheer efficiency of the model plays that role.

MORE THAN 5,000 CAPTIVE INSURANCE COMPANIES NOW DO BUSINESS AROUND THE WORLD.

As early as 1952, Youngstown (Ohio) insurance manager Fred Reiss set up what would now be called a captive insurance company, for a client. In 1963, not long after Kennedy was assassinated and risk was more acutely on people's minds, Reiss set up the first modern-day captive, in Bermuda.

Curiously, Reiss's brainwave, of marrying lower insurance premiums to a tax-free environment in which to nurture earnings, took a while to catch on. Catch on it did, though: more than 5,000 captive insurance companies now do business around the world. Almost 3,000 are domiciled in the Caribbean, 1,200 or so in Europe and Asia, and more than 1,000 in the U.S.

FILLING A NEED

Captives are formed almost daily somewhere around the globe, but formations peak when insurance coverage becomes unavailable or too expensive. That can happen after major events buffet the commercial insurers, such as Hurricane Andrew, 9/11, or Hurricane Katrina.

Most captive insurance is general liability or workers' compensation insurance. Medical malpractice and professional liability are also mainstays. Newer risks being transferred include construction defect liability and worker disability. Since few companies are in the business of insurance themselves, all but the largest use the services of external managers to handle the day-to-day demands of running an in-house insurance company. Many jurisdictions demand it.

The managers, prominent among them the

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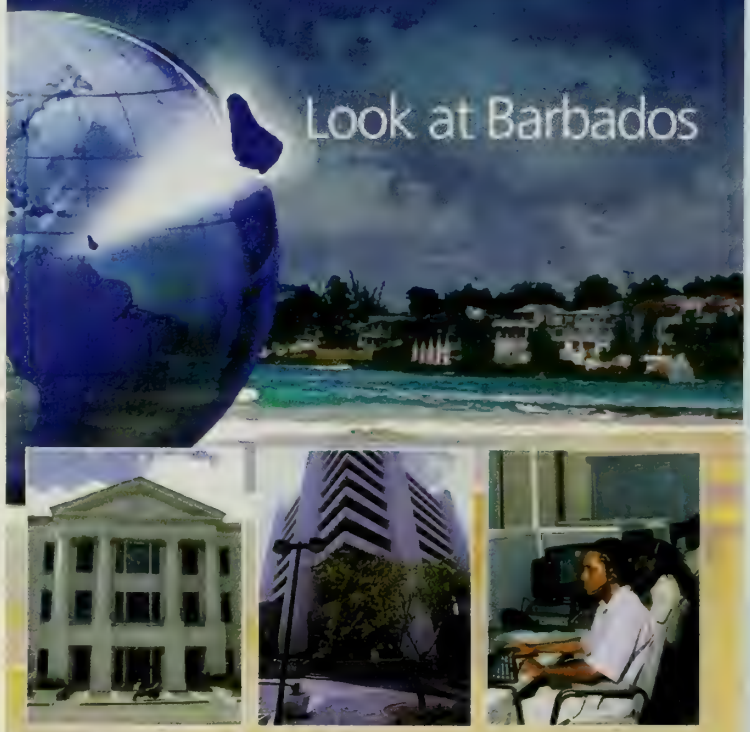

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largest commercial insurance brokers, are represented in jurisdictions. That used to mean a choice of four or five pl in which to domicile a captive. Now, thanks to tremendous growth in the field, there are nearer 60.

THE COMPETITION INTENSIFIES

Indeed, today captive business is keenly sought and cont by domiciles around the world. Bermuda remains the larg single jurisdiction by number of captives. The Cayman Isl are hot on Bermuda's heels, however. "The high level of advisory services that contributed to the growth of Cayma banking and mutual fund sectors were instrumental in driv the steady growth of our captive insurance business," say Kenneth Jefferson, financial secretary of the Cayman Islar "Progressive legislation, a sound legal system, and a bala regulatory regime are the other significant factors that hav helped Cayman secure a leadership position in captive insurance."

The British Virgin Islands and Barbados, neither far awa each has hundreds of captives and have both earned an excellent reputation. "What is proving so attractive about Barbados as a jurisdiction is a combination of its cost-effe pro-business, yet well-regulated and stable environment," Anthony Sobers, chief executive officer, Barbados Investm and Development Corp. "Additionally, an expanding netw tax treaties, modern legislation, developed infrastructure, professional expertise drives Barbados' success as a lea captive domicile."

In Europe, Guernsey, Luxembourg, and Ireland are the market leaders. Places as far apart as Vanuatu, Malta, an Panama are all open for captive business, and Dubai and Bahrain have joined the market as well.

To compete, individual U.S. states began granting capt insurance companies the same benefits they could derive offshore. Colorado was the first, in 1972. Vermont, Hawaii, South Carolina now lead the way, with Nevada and Arizon growing fast. Together, the U.S. was in front with new capt formations in 2005.

"In South Carolina, we view the captive insurance busir as part of our state's overall economic development plan," says Jim Kinder, president, South Carolina Captive Insura Assn. Inc., Simpsonville, S.C. "Alternative risk transfer pro enable organizations to directly manage their risk through solid regulatory system which provides greater flexibility b in contractual form and rating, thus enabling business to r effectively compete in our global economy." Kinder expec more states to enter the fray.

A CONTINUING EVOLUTION

Captive insurance began as an alternative, offshore techr now it is not necessarily either. Like the personal compute captive insurance is an answer to which questions are stil found. Captives are more and more in use, for example, ir developing strategic risk financing programs. Captive insu can only expand as it broadens its focus to meet the neec middle-market corporations and small businesses.

Captive insurance was crowned king, one might say, la 2005, when Lloyd's of London, where the modern practice insurance started hundreds of years ago, lent its imprimat Lloyd's announced that it, too, would facilitate captive insurance.

In the 1960s, for a year or two, Fred Reiss couldn't pers anyone to back his idea of self-insurance, and was warne it by at least one traditional insurance giant. He would hav the last laugh, though. In insurance circles, what were onc considered vices are now habits.

Web directory: **Barbados Investment and Development Corporation** www
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ayman Islands Continue to Captivate

THE CAYMAN ISLANDS' captive insurance industry understands that captive owners have a choice when it comes to selecting or aining operations in a particular ction. Fortunately, many of those e owners choose Cayman. ritish overseas territory located in estern Caribbean, the Cayman s have become a leading jurisdiction ptive insurance over the past 35 . At the end of 2005, 733 captive nce companies were domiciled man, with assets of $26.7 billion nnual premiums of $6.7 billion. By er of companies domiciled, Cayman as the second largest captive nce center in the world. Healthcare orkers' compensation are two of rgest lines of business for these anies, but Cayman captives bring ntages to a wide array of insurance ams.

Many captive insurers do business in George Town, capital of the Cayman Islands.

t minds think alike

perienced cadre of managers, tors, auditors, legal advisors and professionals, combined with essive legislation, a balanced tory regime and a highly preneurial business climate, all bute to one common goal: to ain Cayman's reputation as not only est home in the world for captive rs, but as a gateway for international l and economic growth. man insurance managers play the l role in the day-to-day operations tive companies. With all the world's t managers represented in Cayman, ll as many local firms who are r but equally adept, captive owners tedly speak of the high degree of ssionalism that is the hallmark of an's insurance business. tive insurance offers advantages and cost minimization, as well as s to the global reinsurance markets, is not a financial panacea. Captive nce works best in Cayman when es specific problems or supports ic corporate needs.

Larry Smith, vice president of risk management for MedStar Health, a nonprofit, community-based organization serving the Washington/Baltimore area,

The Cayman Islands Legislative Assembly.

says his company moved its healthcare captive from another jurisdiction to the Cayman Islands in 2004. The reason behind MedStar Health's decision, says Smith: "We found more of what we expected with Cayman. We needed regulators who understood our kind of business. Even more important, they [Cayman] understood the captive insurance company as a strategic part of that business."

A win-win situation

The Cayman Islands have demonstrated leadership in global financial services regulation. The Cayman Islands Monetary Authority (CIMA) supervises and monitors such activity in strict accordance with the highest international standards. The process by which Cayman captives are formed is a consultative one. The potential owner prepares a business plan, which a potential manager reviews to ensure that it meets Cayman's standards and reports all necessary information. CIMA then considers the plan from every angle, including the background of the proposed company's sponsors, before issuing a license that will enable the captive owner to execute the plan.

Cayman believes, and its captive owners are happy to confirm, that the goal of regulation – protection of the insured, the shareholder, and every other stakeholder, including the public – should never be overlooked in a welter of red tape. The success of Cayman's captive owners, in accordance with the dictates of international standards and law, becomes in turn the success of Cayman's population.

EDITED BY
ADAM ASTON

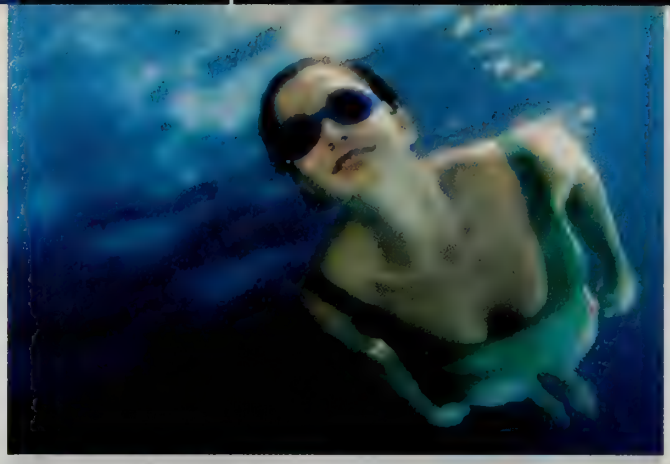
INNOVATIONS

Of cocktails and testosterone

>> Cheers, women! If you want to tune up those brain cells, then have a drink. A continuing study of more than 3,000 New York City residents found that women who had one or two alcoholic drinks a day scored 20% higher on standard cognitive tests than women who didn't drink or consumed less than one a day. The researchers, from Columbia University, say the difference remained after adjusting for income, marital status, race, and other disease factors. The average age of study participants was 65. The correlation was not found in men, but this may have been because there were very few men in the study who never drank. Now if only there were some cheery news about alcoholism.

>> Women aren't so lucky when it comes to testosterone levels. In a meta-analysis of 43 different studies, two researchers from the Harvard School of Public Health found that women with higher than normal levels of the sex hormone had a greater risk of developing Type 2 diabetes, while men with high testosterone were at a lower-than-average risk. The study, published in the Mar. 15 issue of *The Journal of the American Medical Assn.*, suggests that doctors might consider the differing risks of diabetes when prescribing hormone therapies for men and women.

–Catherine Arnst



TANKLESS DIVING

ARTIFICIAL GILLS: ONE BIG STROKE CLOSER TO REALITY

WE ARE MORE evolved than our piscine ancestors, but fish can do something we can't: breathe underwater. Fish gills are a marvel of engineering. By pairing high surface area and precise control of water flow, gills enable fish to thrive on the small amounts of oxygen dissolved in water.

Now scientists are designing artificial gills to supply divers with a steady flow of oxygen from a wearable rig. The key, explains Harihara Baskaran, an engineer at Case Western Reserve University, is getting water to flow easily through microchannels, which mimic a real gill. Working with Infoscitex of Waltham, Mass., Baskaran is using chipmaking techniques to create tiny devices with hundreds of channels. Bump that up to 250,000 channels, and the device could generate enough oxygen for a person. The project is being backed by the military, which has visions of stealthy gill-equipped aqua-warriors.

–John Carey

OBESITY

IT'S EITHER THE DONUTS OR YOUR DNA

THOSE EXTRA FRIES may not be the only thing making you fat. Two new studies have found genes that are closely linked to obesity and the way fat is distributed in the body.

In one large study, researchers at Boston University and Harvard School of Public Health screened more than 86,000 snippets of DNA collected from participants in Massachusetts' long-running Framingham Heart Study. One gene variant found in 10% of subjects was consistently linked to obesity. Studies of three other population groups confirmed the results.

Separately, scientists at the Joslin Diabetes Center in Boston screened DNA to find genes that determine whether fat is stored inside the abdomen, where it is most dangerous, or under the skin. Examining both mice and humans, they found three genes that correlated with a predisposition to accumulate belly fat.

Authors of both studies cautioned that the presence or absence of these genes is not destiny, since many overweight people lack these markers. So it's still best to skip the fries.

–Catherine Arnst

SECURITY

USING FACES TO MAKE MEMORABLE PASSWORDS

NEVER FORGET A FACE? Yo not alone. The ability to faces is so hardwired int brains' visual processing areas that even infants c it. This follows since, as species, human survival depended partly on the ability to recognize kin.

These days, remembe password for a cash mac or a PC is nearly as impo Facial recognition can h there, too. Privately held Passfaces, in Annapolis, has come up with a syste that capitalizes on this h skill. From a library of thousands of faces, the system assigns you five shots. You then go throu short training session, ir which you practice picki each one out of a grid of other faces. From then o you log in by clicking on

preassigned faces in a se of grids. "Even after yea users can still recognize them," says CEO Paul B

The system is less pro theft from keystroke-sni programs and other ma than regular passwords, Barrett, and works even cell-phone screens. With few U.S. agencies now u Passfaces, Barrett is buil larger face libraries to prepare for a global roll

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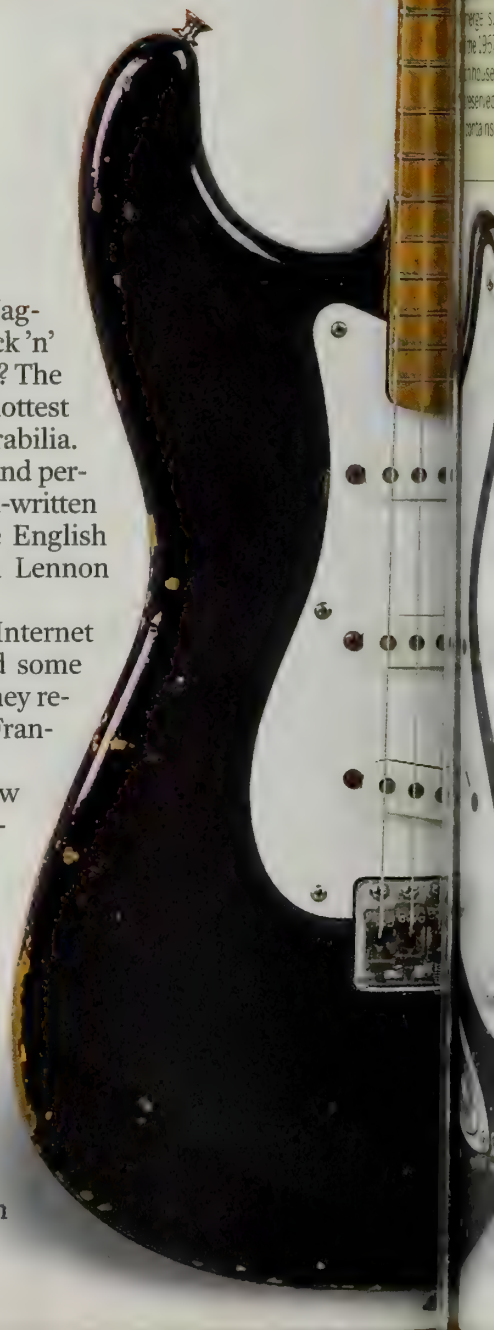
Rock 'n' Roll Is Here to Sell

Boomers are driving a memorabilia market that's...well...rockin'. **BY THANE PETERSON**



BACK IN THE 1960s, who would have guessed Mick Jagger would still be stalking the stage at 62 or that rock 'n' roll history would be chronicled in major museums? The music's enduring appeal has spawned one of the hottest hobbies around: collecting rock 'n' roll memorabilia. Everything from old records, intact concert tickets, and performers' clothing is collectible, but guitars and hand-written lyrics often fetch the biggest bucks. Last year the English auction house Cooper Owen sold the page on which Beatle John Lennon hashed out the lyrics to *All You Need is Love* for $1.2 million.

Baby boomers like Joe Armstrong, 56, a top executive at Sterling Internet Solutions in Irvine, Calif., are the main collectors. He has amassed some 20,000 concert posters (vintageconcertposters.com), partly because they remind him of playing in a rock band as a teen and hanging out in San Francisco during 1967's Summer of Love before heading off to college.

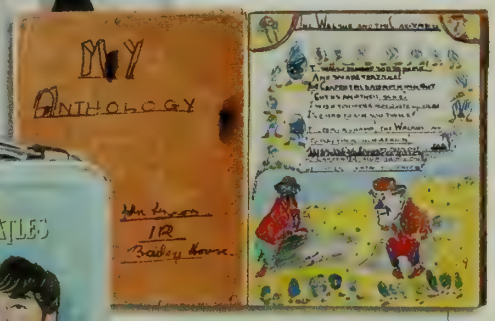
A cool thing about the hobby is you can log on to the Internet right now and probably find good material to buy without spending a fortune. Collector John Shiely, 53, CEO of Milwaukee's Briggs & Stratton, recommends consulting sales at cooperowen.com and itsonlyrocknroll.com. He also tracks occasional sales by Sotheby's, Christie's, and Bonhams & Butterfields and peruses catalogs from dealers such as R&R Enterprises Autograph Auctions (rrauction.com) of Amherst, N.H.

A good source for vintage t-shirts, photos, and other items starting at under $100 is Wolfgangsvault.com, recently launched by Bill Sagan, 56, who bought the archives of the late San Francisco rock promoter Bill Graham. You'll find lots of material on eBay, too, but "make sure you know that what you're buying is the real deal because there are lots of forgeries," advises Don Bernstein, who assembles the rock memorabilia Hard Rock International features in its cafés, hotels, and casinos. ■

(CLOCKWISE FROM CENTER) CHRISTIE'S IMAGES LTD. 2006; COURTESY COOPER OWEN PLC (2); COURTESY OF ITSONLYROCKNROLL.COM (3)

Beatlemania Lives

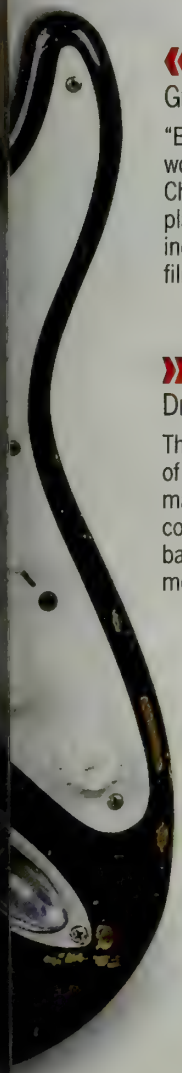
e Fab Four are tops as far as rock collectibles go, with John nnon being in a class by himself. New material continues to nerge, such as the wax likenesses used in creating the cover the 1967 *Sgt. Pepper's Lonely Hearts Club Band* album. Auc- n house Cooper Owen expects Lennon's schoolboy notebook 'eserved by a teacher) to command top dollar partly because :ontains early intimations of his surreal *I Am the Walrus*.



Wax heads from the *Sgt. Pepper's* album cover $150,000

John Lennon's sketch book $175,000 to $350,000

Beatles lunch box $500 (est.)



« Eric Clapton

Guitar $959,500

"Blackie," a battered 1950s Fender Stratocaster, set the world record for a guitar at a 2004 charity auction at Christie's. One reason: Clapton treasured the guitar, playing it from the early 1970s through the mid-'80s, including during Martin Scorsese's classic concert film, *The Last Waltz*.

» Nirvana

Drum head $18,814

The tragic death of band leader Kurt Cobain in 1994, of self-inflicted gun shot wounds at age 27, helps make Nirvana material prized objects for younger collectors. In 1993, Cobain sketched caricatures of band members on this drum head, which band members also signed.

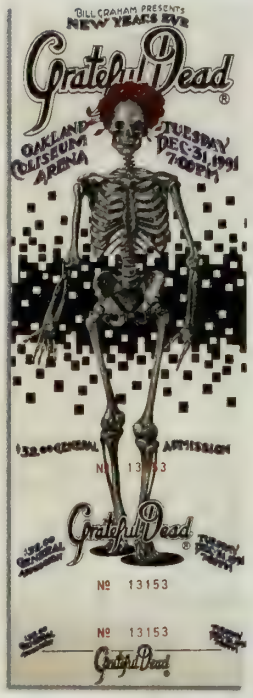
« Elvis Presley

Board Game $3,000 - 5,000

Licensed products such as games, lunch boxes, and dolls are among the more affordable rock collectibles, ranging in price from a few hundred dollars into the thousands. The June 2 auction at itsonlyrocknroll.com will feature a good selection.

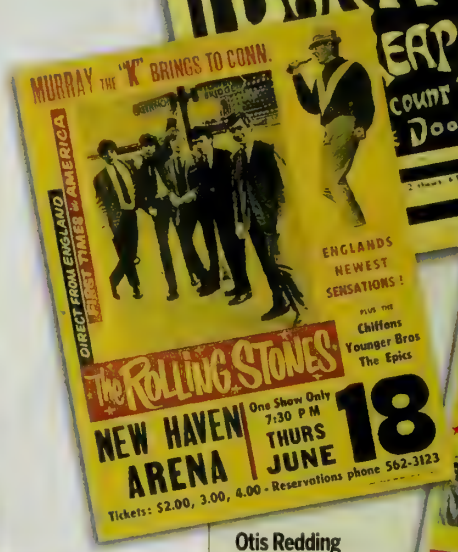
Jimi Hendrix
Necklace $150,000 (est.)

Clothing and jewelry is worth the most if it's documented in photos or videos of key performances. Hendrix wore this necklace during his legendary 1970 Isle of Wight concert; it can be seen around his neck in the cover photo of the live concert album.



Grateful Dead
1991 concert ticket $276

If your budget is tight, concert tickets, backstage passes, and programs are among the least expensive rock collectibles. Grateful Dead tickets range from a few dollars to more than $1,000 at wolfgangsvault.com.



Johnny Cash
Guitar $131,200

As with any collectible, provenance is key. Items at a 2004 Cash estate sale at Sotheby's such as this 1960s Grammer acoustic guitar labeled "Custom Made for Johnny Cash" inside, commanded top dollar because authenticity and importance to the artist were certain.

Otis Redding
$10,000 (est.)

Chuck Berry et. al.
$35,000

Rolling Stones
$24,000

Dates with History

Historical importance helps determine value. The record price, set last year at itsonlyrocknroll.com, is $132,737 for poster advertising the Beatles' 1966 concert at New York's Shea Stadium, one of only six to survive. This Redding poster (1967) advertises a concert that was to have taken place the day the singer died in a plane crash. The concer in the Stones poster (1964), from the Joe Armstrong collection, was canceled for lack of interest. The Chuck Berry poster (1955), also from Armstrong, is believed to b the first using the term rock 'n' roll.

(CLOCKWISE FROM TOP LEFT) COURTESY OF COOPER OWEN PLC; COURTESY OF ITSONLYROCKNROLL.COM; COURTESY OF JOE ARMSTRONG (2); SOTHEBY'S NEW YORK; COPYRIGHT WOLFGANGSVAULT.COM

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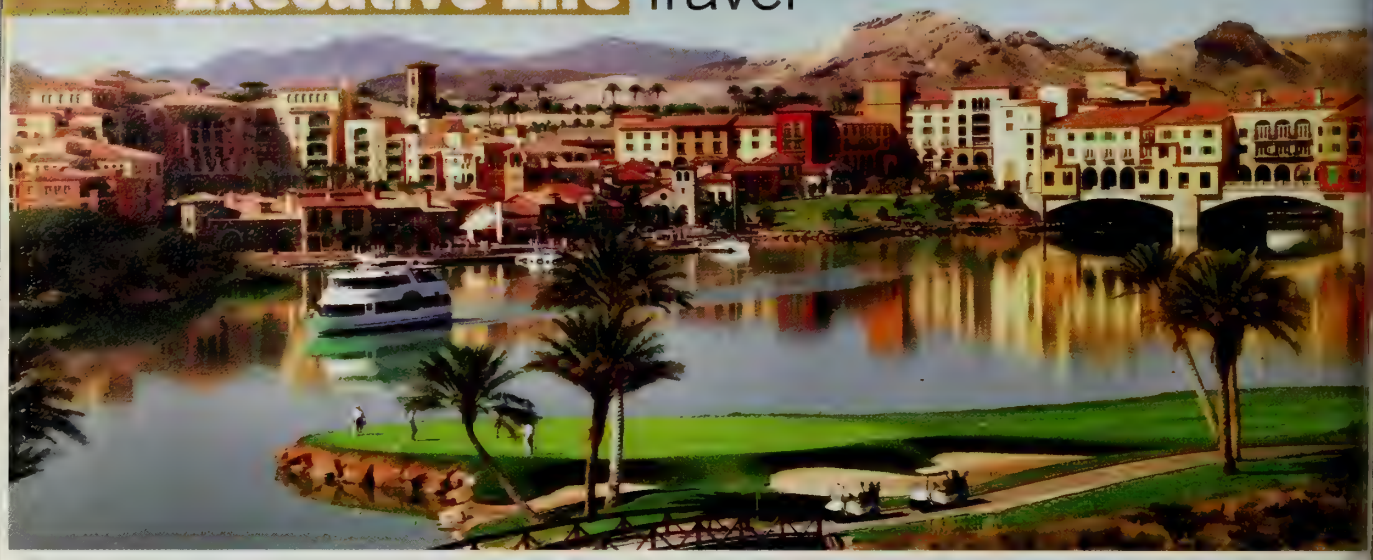

Almost Leaving Las Vegas

Luxe resorts far off the Strip offer a different kind of Vegas vibe. **BY CHRISTOPHER PALMERI**

AT THE MAIN ENTRANCE of Las Vegas' newest pleasure palace, guests are greeted by a reflecting pool decorated with palm trees, a waterfall, and torches that shoot flames three feet into the air. Inside hang dozens of crystal chandeliers—nine miles' worth of glass if their pendants were laid end to end—that fill the lobby and centermost bar like a low-hanging electrical storm. In the garage, a half-dozen maroon limousines sit waiting to be dispatched for high rollers.

Everything is in place for the Apr. 18 opening of the Red Rock Casino Resort and Spa. Just don't expect to find the $925 million property along the city's famous Strip. Red Rock is located 12 miles west, in Summerlin, a vast expanse of tract housing that calls itself "Las Vegas' premier master planned community."

What? Go to Sin City and stay in the 'burbs? Frank and Dino would have dropped their martinis at the idea. But Red Rock is just the latest in a string of luxury hotels that have opened up far from the Vegas action. The 400-room resort was developed by Las Vegas-based Station Casinos. It is targeting what Chief Executive Frank Fertitta III calls "tourists in the know."

Not long ago the formula for off-the-Strip properties was simple: cheap food and better odds. But that's no longer the case. In 2001, Station opened the $500 million Green Valley Ranch, a 490-room Strip-worthy casino hotel about 10 miles southeast of the Bellagio and its ilk.

Red Rock, too, is looking for guests who want to be pampered. It's designed in a "desert modern" style that Fertitta and his brother, Lorenzo, Station's president, say harks back to the glory days of Vegas resorts such as the Sands and the Desert Inn in the 1950s and '60s. Its name and ample quantities of sands and rock play off the austere beau nearby Red Rock Canyon National servation Area. Red Rock is dedicat creature comforts, including suites flat-panel TVs in the bathrooms. A suite for Memorial Day weekend $220 per night, vs. $380 for a comp ble room at THEHotel at Mandalay on the Strip.

UN-STRIP TEA
Lake Las Veg 19 miles from action, boast two resorts

Another developer who shares Fertittas' vision is Ronald Boeddek the mid-1980s he began acquiring in the Las Vegas suburb of Hende 19 miles east of the Strip. After faili get the big casino operators intere he developed the resort himself, t seven years to build a dam across a nicipal water shed and fill a 320 body of water he called Lake Las V Boeddeker's first hotel, a Hyatt, op in 1999. A 349-room Mediterra themed Ritz-Carlton followed years later.

Lake Las Vegas visitors can fish sail, play golf on two hillside cours stroll through a replica of an Italia lage. Construction trucks still r through on a regular basis, bu what Boeddeker says will ultimat 9,000 high-end homes.

For those who want to see Vegas out hordes of tourists and conventio the off-the-Strip hotels are an altern On a recent Thursday morning the casino at Lake Las Vegas' Hyatt was tically empty. "This is where they'll you how to play," Boeddeker says. T teach you on the Strip, too. But yo have to elbow your way to a table.

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LUGGAGE

GET A HANDLE ON PESKY BAGGAGE FEES

MOST AIRLINES TIGHTENED UP the rules last fall on bags that you can check for free. You're now allowed two, at 50 pounds each. With fees for exceptions approaching the punitive, it's a good idea to weigh your bags on the bathroom scale before you leave home. But what about when you're packing those souvenirs in your hotel room the night before your return? Ricardo Beverly Hills Solutions luggage has the answer: a built-in digital scale. Lift it by the carry handle and the display on top tells you the weight of the bag and its contents, up to 100 lbs. The 25- and 28-inch pullmans are $180 and $200, respectively, at Macy's stores. *–Larry Armstrong*

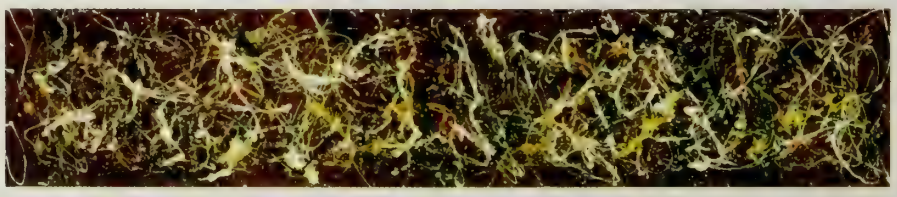
NIFTY FEATURE A built-in scale on Ricardo Beverly Hills Solutions luggage keeps track of its weight

GIVING

Big Easy Bandann

A SILK HERMES SCARF has long conveyed status and elegance. Now the chic acce also symbolizes support for rebuilding New Orleans. The French luxury-goods has reissued a 10-year-old design featuring a tribute to the Big Easy's musical heritage. Hermès says it's donating a portion of the limited-edition scarf's $32 price tag to the city's Louisiana Historical Society to help restore the flood-rava Hines Carousel Gardens amusement area in New Orleans' City Park.

Available in orange, black, or white at Hermès boutiques and hermes.com, t 36-inch-by-36-inch scarf features bold illustrations of musical instruments surrounded by a tableau of jazz greats and New Orleans symbols. Even though proceeds go to charity, you can't take the scarf as a tax deduction because objec sold at fair-market price don't qualify. *–Reen*



TIME OFF

An exhibition at the Williams College Museum of Art in Williamstown, Mass. (wcma.org) is bringing some of Jackson Pollock's extremely fragile drip paintings to the Berkshires. The show, which runs from Apr. 14 to Oct. 1, is a tribute to former Museum of Modern Art chief curator Kirk Varnedoe, a Williams alum who died in 2003. One of the frieze-format paintings, *Number 2, 1949,* is 16 feet by 3½ feet and was recently restored at the Williamstown Art Conservation Center.

ONLINE

WRITE YOUR OV TRAVEL GUIDE

ONE OF THE MOST popular Web sites been Wikipedia, the online encyclo where users continually update the entries. Now the travel-gossip site TripAdvisor is trying the Wiki form Starting Apr. 12, its 18 million mon users can contribute to the site's gu destinations around the world. "It's going to turn the travel guidebook industry on its head," says CEO Ste Kaufer. He adds that ongoing upda will make his Wiki fresher than a F book could ever be. *–Timothy J. Mu*

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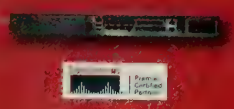

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A Capital Crowd

A kind of high-end investment club, Tiger 21 gives its multimillionaire member chance to share deals, financial advice, and a few life lessons. BY TODDI GUTNI

THOMAS GALLAGHER SHIFTED UNEASILY in his seat. He waited for each of the 10 people around the conference table to review his 15-page financial report and braced himself for the barrage of questions, criticisms, and laughter. ¶ Laughter? Gallagher, the 60-year-old former vice-chairman of CIBC World Markets, had distributed a printout of his net worth to fellow members of an unusual peer group of multimillionaires called Tiger 21. The camaraderie and banter among the men and women in the room eased his anxiety. "Hey, Tommy, have you put your house in a QPRT?" asked one (referring to a qualified personal residence trust, an estate planning tool).

Tiger 21, which stands for The Investment Group for Exceptional Returns in the 21st Century, is a cross between a high-end investment club and group therapy. The entrepreneurs, corporate chieftains, and Wall Street wizards get together one day a month to talk about how to preserve and increase their wealth. On this mid-March morning in a Manhattan town house leased by the group, Tiger 21 gave *BusinessWeek* access to one of its confidential day-long meetings. As part of the deal, we agreed not to divulge the names of participants who wanted to remain anonymous.

To qualify for admission, members must have at least $10 million investable assets (excluding real estate, art, and collectibles). They also have to ante up $25,000 a year in dues, which covers meeting expenses, rent, speaker fees, and salaries for six staff members. Membership in the seven-year-old organization has doubled in the past year, to 74 men and 5 women, meeting in groups of 12. The average age is in the mid Members are mostly from New Yorl offices in Florida and California are to open soon. The goal: 300 membe

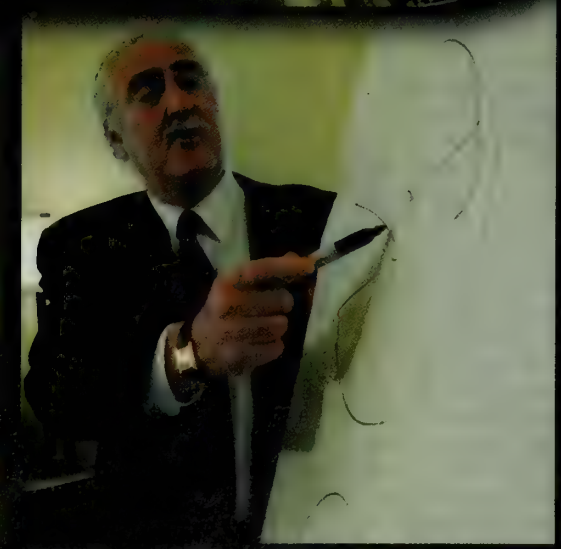
Interest in Tiger 21 reflects gro concern among the wealthy that p bankers, trust companies, and brok firms have a not-so-hidden agenda financial products and services. "I fe advice I was getting was always tain says Michael Sonnenfeldt, a 50-yea real estate developer who co-fou Tiger 21 as a profitmaking venture, ing its money from memberships. C have formed similar groups wher wealthy can swap ideas without the sure of a hard sell (table).

What makes Tiger 21 unique i participants are encouraged to inve gether, and in fact, potential membe admitted based on their ability to deals to the table. The idea, says So feldt, "is to create a collective intelli and build a confederation of inv who are always looking out for eac ers' interests." For example, a yea Patricia Cloherty, CEO of Delta P Equity Partners, needed to raise $1 lion more to close its $120 million Russia Fund. Sonnenfeldt, who kne invited her to a Tiger luncheon, ar walked out with commitments to $9.3 million.

Another Tiger 21 partnership b into a Texas oil well, while three are investing in real estate on the I Rican island of Vieques. Amnon B managing partner of SafeHarbor ings, an investment holding compa cently joined a fellow Tiger membe together they raised $330 million investors to build a Hard Rock Park in Myrtle Beach, S.C.

Mutual Aid Societies

NAME LOCATION WEB ADDRESS	MINIMUM WEALTH (MILLIONS)	COST	MEMBERSHIP
CCC Alliance **Boston** cccalliance.com	**$100**	Initiation fee varies, plus $12,000 annual dues	70 families
Family Office Exchange **Chicago** foxexchange.com	**$100**	Sliding scale, up to $20,000 annually	358 individuals/ family offices
Institute for Private Investors **New York** memberlink.net	**$10**	From $2,000 to $9,000, depending on level of participation	300 individuals/ family offices
Tiger 21 **New York** tiger21.com	**$10**	$25,000 annual dues, covers the cost of monthly meetings	79 individuals



Inside Tiger 21

Members meet once a month to discuss how to preserve and increase their wealth.

FAR LEFT Co-founder Sonnenfeldt with members Kress and Bar-Tur

LEFT Co-founder Lavin, who has previously run a peer group for CEOs of private companies called The Executive Committee

hy enough where we can pool our as- nd open our own doors into alternative ments," says Sonnenfeldt. Indeed, the 's total assets surpass $5 billion.

ny Tiger members are entrepreneurs have cashed out of their businesses, h some are still working. They've had oblem making money but don't feel as lent making sure it lasts. "Getting rich the same as staying rich," says an 82- ld real estate developer.

RETURNS

NALD BRACK, THE FORMER chairman EO of Time Inc., says his Tiger mem- ip is well worth the time and expense. d been a client of a preeminent invest- bank for six years and paid huge fees. s returns were flat. In 2005, the first e managed his money on his own with Tiger 21's help, his portfolio was up 8% (net of fees). "My costs are less than half of what they were," he says. Two other members found out at a meeting that they shared an investment manager but were charged different fees for the same service. They confronted the manager who cut the fee for the man who had been paying more.

Sonnenfeldt is used to starting ventures. After graduating from Massachusetts Institute of Technology, he went on to Goldman Sachs and worked in the real estate group for about a year. He moved into New York real estate, and by age 30 he had cashed out of a huge commercial renovation project (New Jersey's Harborside), splitting $120 million in proceeds with a partner. By 42, he had built and sold a company that bought property from failing savings and loans. At the time he was a member of The Executive Committee (TEC), a peer group for CEOs of private companies. Six of the members had sold their businesses, and he asked them if they were interested in forming an investor club. He asked Richard Lavin, the TEC group facilitator, to join him as a co-founder of Tiger 21.

Besides having the financial means to join, Tiger 21 members must be willing to disclose their entire investment portfolio once a year. "Doing a portfolio defense is like taking your clothes off in public," says one member who runs a wealth management division for a major Wall Street firm.

Gallagher's portfolio defense was one of the highlights of the day-long meeting

BusinessWeek observed. Gallagher said he was content with the annual return of 9.1% on his portfolio of mostly hedge funds, private equity, real estate, artwork, stocks, and bonds. Since his last annual review, Gallagher had put a few million dollars into two investments—a hedge fund and a real estate fund—because the managers of both felt "like me, much more negative about the state of our economy and the world." Several members challenged him on his bearish views. In his defense, Gallagher said: "I'm looking at investment opportunities differently, and if I lose 10% in these investments, I'll pull out."

When the meeting began, members shared news of the changes in their lives and their portfolios since the last get-together. Some were questioned on moves they had made in both. When a former investment banker commented that he was "looking into starting a money management firm," another member asked: "Is this really what you want to do? Won't it significantly alter the time you spend with your kids?" He said he wasn't planning on doing it full time.

Each group meeting has two speakers. The day's first was James Melcher, chief investment officer of hedge fund Balestra Capital, which had received an investment from a Tiger member. Although Melcher was not a particularly dynamic speaker, he was nonetheless pelted with questions about his investing strategy.

The focus can shift from their wallets to their psyches

Later, the members shifted focus from their wallets to their psyches. Lunchtime speakers Jeri Sedlar and Rick Miners, the authors of *Don't Retire, REWIRE!*, led the members through an exercise to figure out what they wanted to do next as they turned their attention away from working full time. Sedlar asked: "How many of you have a passion, and what is it?" Most didn't have an answer.

Clearly, Tiger 21 isn't just about deal-making. Mark Kress, CEO of Spencer Forrest, a maker of hair products, says the group has prevented him from making bad investments and helped him disentangle himself from some messy tax shelters. "There isn't a major decision I would make without the support of the group, be it financial, marital, health, or family," says Kress. "It's a kind of therapy you can't get on the couch." ■

New Tool for Your Retirement Kit

Vanguard's revamped, simple-to-use service can provide a streamlined strategy. BY LAUREN YOUN

I HAVE A CONFESSION: Although I've been writing about personal finance for over a decade, my own retirement savings plan is a mess. My husband and I, both 38, have accumulated three 401(k)s, two rollover Individual Retirement Accounts, two Roth IRAs, and a pension plan, along with five taxable accounts at brokerages and fund companies. We contribute to our employers' retirement plans, but we have no asset allocation strategy and no clue how much we need to save. Retirement isn't our only goal: College money is also a priority since we have a 17-month-old son bound for Yale in 2022 (or so his father thinks). We also want to buy a home soon.

Those are lofty objectives. So when Vanguard Group offered *BusinessWeek* a first peek at its newly revamped financial-planning service that it's unveiling Apr. 17, I decided to take a test drive. (We're already Vanguard customers.) The program combines an online questionnaire with over-the-phone advice from one of Vanguard's 200 financial planners.

The service is free to anyone with $250,000 or more at Vanguard or $1 for those with less. It's also free i transfer $100,000 to a Vanguard acc Vanguard has been offering fee-bas nancial advice since 1996, but the e iteration resulted in a 50-page fina plan that was difficult to digest.

CUTTING THE KEYBOARDING

THE STREAMLINED service includ set allocation advice, portfolio re mendations, and a college savings s gy, all in fewer than 20 pages. "Sim better," says John Brennan, Vangu chairman. Another difference is price: The old program cost $1,500.

Getting started seemed easy en We had a lot of financial informati our fingertips from tax season. Whi hold accounts at Fidelity Investm Wachovia, and a few other places, I need to key in all of my account inf tion. With software called Cash Vanguard can retrieve your data h at other financial institutions, assu you have the passwords. Data from of my accounts, however, didn't tra and had to be entered manually.

The Price of Advice

Charles Schwab Advised Investing	Fidelity Portfolio Advisory Service	Fidelity Retireme Income Advanta
COST $2,000 to $3,000.	**COST** Ranges from 1.1% of assets for investors with $50,000 to 0.25% for those with $8 million.	**COST** Free, and you to be a Fidelity clie
COMMENTS Clients fill out a 20-page questionnaire on assets and financial goals and receive a 50-to-100-page plan. Investment suggestions include a mix of Schwab and non-Schwab mutual funds.	**COMMENTS** After you identify risk tolerance and asset allocation mix, Fidelity takes control of investment decisions.	**COMMENTS** Design within 10 years of r financial planner c comprehensive ret income plan, inclu withdrawal strateg meet your expense

en turned to the questionnaire, asked for basic information on our s, savings, income, and expenses. I swered a series of questions on my ce for risk-taking. Completing the took about 20 minutes, although I sure what I should put for our ex- retirement age since people are g longer. I stuck with 65, the de- tting. Since we live in pricey Man- , I upped the rate to 80% from the 70%, the amount of our pre-retirement income we'll need to maintain.

Less than 24 hours later, I got an e-mail that my financial plan was ready for review at Vanguard.com. The good news: We've accumulated more than $200,000 in retirement savings. Our recommended asset allocation plan is 80% stocks and 20% bonds, a slight shift from our current 90/10 as measured by the program.

The bad news: To meet our projected retirement goal of more than $4.8 million, we need to save $67,500 more annually, which seems unrealistic, in part because federal law limits how much you can stash away tax-free.

My financial planner, Mark Yakupcin, trimmed our portfolio of 30 funds from varied companies to a mix of 10 Vanguard funds, which have lower expenses. As an alternative, the plan suggested I simply use Vanguard LifeStrategy Growth Fund, a managed mix of stocks and bonds. I didn't like the recommendation to dump my stock in *BusinessWeek* parent McGraw-Hill and Vanguard Health Care Fund because they didn't fit the asset allocation strategy. I asked Yakupcin to put both back in the plan.

To help us meet our goal, Yakupcin factored into the retirement plan $20,000 from our taxable accounts and extended our retirement age to 70. Three days later a new plan arrived. Those key changes helped us get to a more manageable savings rate of $25,000 per year. I can cover some of that by upping my 401(k) contributions. Medical expenses prevented me from putting away more in 2005. The plan also suggests that we save more than $5,000 per year for our son's college fund, so we've opened up a 529 savings plan.

I asked Dan Wiener, editor of the *Independent Adviser for Vanguard Investors* newsletter and an adviser himself, to review the recommendations. He thought the plan was fine, but griped that the fact we need to save $25,000 more per year "is the most important part of this whole plan...and it's buried" on page three.

How does Vanguard's service compare with the competition? At Fidelity Investments, the most comparable program is a fee-based advisory service that includes real estate holdings, which Vanguard's service does not. "Real estate valuation is very subjective based on an unlimited set of circumstances and is not viewed as an income source by most investors," says Vanguard spokeswoman Melissa Nigro.

The Vanguard plan is certainly simpler than Charles Schwab's $2,000 service, which links you with an adviser and results in a 50-to-70-page report. T. Rowe Price offers a $250 annual checkup that focuses on asset allocation, not strategy, and can be submitted only by snail mail.

By playing around with some numbers, Vanguard helped create a retirement plan that seems reasonable enough. The hard part will be to stick to it. ■

ice t Checkup	Vanguard Financial Planning Service	Vanguard Financial Planning Service-Plus
Customer mails in uestionnaire on dings, and lls to review asset commendations. s not designed to much you will rement.	**COST** $1,000, or free if you have $250,000 in assets at Vanguard or transfer $100,000 to Vanguard. **COMMENTS** Online survey results in a plan under 20 pages. Planner reviews asset allocation and portfolio to help meet retirement goals.	**COST** $1,000 for accounts with less than $250,000 to $500 for accounts with $1 million and up. **COMMENTS** Like the basic service, but includes cash flow, insurance, enhanced education, and estate planning services.

BY GENE G. MARCIAL

AS SUBSCRIBERS FLOCK IN, THE CASH PILES UP AT DIRECTV.

HAIN CELESTIAL IS RIDING HIGH ON THE ORGANIC FOOD WAVE.

WHY GEORGE SOROS' INVESTMENT FUND HAS BETS ON VALENTI

More Eyes on DirecTV

INVESTORS ARE TUNING BACK to DirecTV Group (DTV). After tumbling from 16 last summer to 13 in December, shares of the No.1 U.S. satellite broadcaster, with 15 million subscribers, have rebounded to 16.50. For one thing, investors are paying more attention to the cash flow and earnings of companies in the industry. And DTV, in which News Corp. has held a 34% stake since 2003, is "an attractive cash-flow play in an environment of slowing profits," says David Sowerby, portfolio manager at investment firm Loomis Sayles, which owns shares. Sowerby expects free cash flow will more than double, to $2 billion, by 2008, up from an estimated $875 million this year. DTV, now chaired by News CEO Rupert Murdoch, will use some of that to finance a $3 billion, two-year share buyback announced in February. Revenues should grow at an annual rate of 12% to 13% for the next three years, says Sowerby, who expects the stock to reach 21 in a year. The shares could go much higher, he says, if DTV's launch of HDTV by yearend and its upgrading of services such as DVRs succeed. Todd Mitchell of securities firm Kaufman Brothers expects the company to add 1 million new subscribers this year. For 2006 he sees earnings of 81¢ a share on revenues of $14.6 billion, and for 2007, $1.01 on $16.3 billion, vs. 2005's 24¢ on $13.2 billion. At 16.3 times 2007 earnings, DTV is a "buy," he says.

Hain Celestial, A Natural Star

THE CUSTOMER APPEAL OF ORGANIC and natural foods continues to swell, and so does investors' appetite for Hain Celestial Group (HAIN). The stock has climbed to 24.95, up from 17 in October. Hain, the industry leader, produces foods that are minimally processed and largely free of artificial ingredients and preservatives. Grocery products are its biggest line, accounting for 55% of sales, followed by tea products at 16% and snacks at 14%. "Healthy eating has become very much a way of life," says Robin Manners West, portfolio manager at New Mexico's State Investment Office, which owns shares. Hain has lots of room to grow, she says, because the industry's spurt is just starting. She expects the stock to reach 32 to 34 in a year. "Hain commands leading positions in 13 of the top 15 natural and organic food categories," which are among the fastest-growing in the industry, says Richard Joy of Standard & Poor's, who rates the stock a "buy." That makes Hain "an attractive acquisition target for big food companies," says Joy. He expects Hain will earn $1.10 a share in the 2006 calendar year and $1.60 in 2007, vs. just 59¢ in 2005.

A New Valentis Drug Fights Plaque in Arteries

LEGENDARY INVESTOR GEORGE SOROS remains upbeat on young biotechs. His Perseus-Soros Bio Pharmaceutical Fund this year has upped its stake Valentis (VLTS). The company is developing products to peripheral arterial disease (PAD), an inflammatory disor that leads to plaque formation in blood vessels, mainly i legs. Dennis Purcell of Perseus-Soros, which now owns 1 says its chief product, VLTS 934, has proved in Phase 2 t to be "safe and efficacious" in treating PAD. In 2004 the stock rose to 6 soon after Soros bought in. But even when the stock slid to 3 last year, Soros didn't sell any shares. "Our fund invests in late-stage compounds with large markets, and Valentis fits our strategy," says Purcell. Data from a second Phase 2 trial, due in July, are expected to be positive, says Kevin DeGeeter of investment bank H.C. Wainwright, who rates Valentis, now at 2.99, a "buy," with a 12-month target of 6.50. With some 5 million Americans suffering severe PAD, VLTS 934 has a potential market of at least million, DeGeeter says. CEO Benjamin McGraw III says in talks with big drugmakers as partners to co-produce market VLTS 934.

BusinessWeek online Gene Marcial's Inside Wall Street is pos businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nc firms hold positions in the stocks under discussion. Similarly, they have no inve banking or other financial relationships with them.

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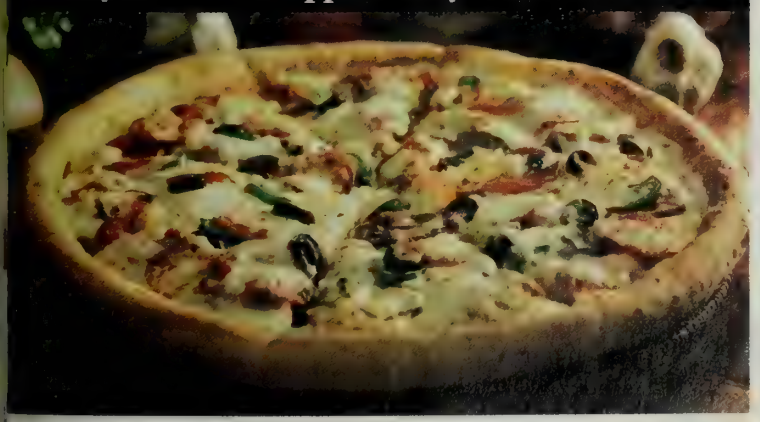

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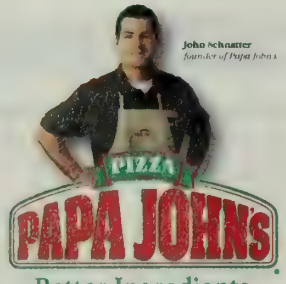

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Personal Finance Figures of the Week

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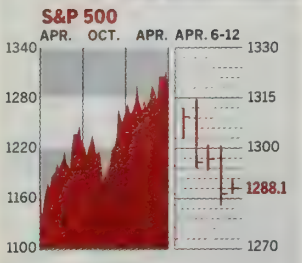


COMMENTARY

Although NASDAQ hit a 52-week high on Apr. 8, the indexes ended the week lower. Unease over rising oil prices, nearing $70 a barrel, and bond yields, flirting with 5%, sent traders to the sidelines. Equities have risen on the hope that the Fed was done tightening, but that's no longer a sure bet. With earnings just starting to trickle in, there was little news to stimulate buying.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	APR. 12	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1288.1	-1.8	3.2	8.4
Dow Jones Industrials	11,130.0	-1.0	3.8	5.9
NASDAQ Composite	2314.7	-1.9	5.0	15.4
S&P MidCap 400	783.7	-2.0	6.2	19.4
S&P SmallCap 600	386.6	-2.4	10.3	20.6
DJ Wilshire 5000	13,016.6	-1.9	4.2	11.3

SECTORS

BusinessWeek 50*	776.0	-2.0	4.6	10.4
BW Info Tech 100**	396.4	-1.9	4.2	13.2
S&P/Citigroup Growth	604.4	-1.8	1.3	5.5
S&P/Citigroup Value	680.9	-1.8	5.1	11.5
S&P Energy	412.4	-1.4	10.6	22.6
S&P Financials	435.5	-1.9	2.1	12.8
S&P REIT	165.1	-3.6	7.9	22.6
S&P Transportation	281.8	-1.2	12.8	26.8
S&P Utilities	154.1	-3.7	-3.5	1.1
GSTI Internet	195.0	-1.6	-5.0	24.4
PSE Technology	864.7	-1.9	3.4	19.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	APR. 12	WEEK	% CH YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1658.0	-3.2	8.7
London (FT-SE 100)	6000.8	-0.7	5.8
Paris (CAC 40)	5085.1	-2.6	7.8
Frankfurt (DAX)	5901.3	-2.1	9.1
Tokyo (NIKKEI 225)	17,162.6	-0.5	6.5
Hong Kong (Hang Seng)	16,310.8	1.3	5.6
Toronto (S&P/TSX Composite)	12,167.7	-1.1	7.9
Mexico City (IPC)	19,322.6	-3.1	8.5

FUNDAMENTALS

	APR. 11	WEEK AGO
S&P 500 Dividend Yield	1.79%	1.72%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.9	18.2
S&P 500 P/E Ratio (Next 12 mos.)*	14.6	14.8
First Call Earnings Surprise*	17.76%	16.70%

*Fir

TECHNICAL INDICATORS

	APR. 11	WEEK AGO
S&P 500 200-day average	1246.7	1244.4
Stocks above 200-day average	63.0%	67.0%
Options: Put/call ratio	0.73	0.76
Insiders: Vickers NYSE Sell/buy ratio	5.45	5.22

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Divsfd. Metals & Mining	24.8	Steel	80.1
Aluminum	16.6	Divsfd. Metals & Mining	76.2
Agricultural Products	16.0	Agricultural Products	71.4
Oil & Gas Refining	16.0	Oil & Gas Refining	70.3
Constr. Materials	13.5	Oil & Gas Equip.	67.7

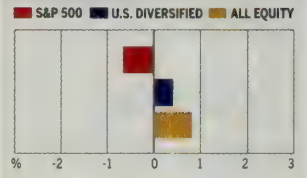
WORST-PERFORMING GROUPS

	LAST MONTH %	
Health-Care Supplies	-15.2	Automobiles
Distillers & Vintners	-9.3	Home Furnishings
Household Products	-7.6	Photographic Product
Automobiles	-7.3	Health-Care Facilities
Photographic Products	-7.2	Broadcasting

MUTUAL FUNDS

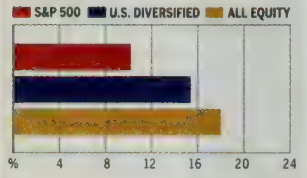
4-WEEK TOTAL RETURN

WEEK ENDED APR. 11



52-WEEK TOTAL RETURN

WEEK ENDED APR. 11



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	10.6	Latin America	74.9
Pacific/Asia ex-Japan	7.0	Precious Metals	70.5
Diversified Pacific/Asia	6.8	Diversified Emerg. Mkts.	50.2
Natural Resources	6.5	Japan	44.0
LAGGARDS		**LAGGARDS**	
Health	-5.3	Domestic Hybrid	8.6
Utilities	-2.6	Utilities	10.7
Real Estate	-1.8	Large-cap Value	11.0
Financial	-0.6	Large-cap Blend	11.2

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Frontier MicroCap	26.3	ProFunds Ultra Japan Inv.	112.1
American Heritage Grth.	25.0	U.S. Global Invrs. Gold	101.5
Dreyfus Prmr. Gr. China A	15.9	ING Russia A	97.6
Oppenheimer Gold & Mins. A	14.3	Midas	96.4
LAGGARDS		**LAGGARDS**	
Ameritor Investment	-16.7	Ameritor Investment	-66.7
Franklin Biotch. Dscvry. A	-9.4	Potomac Sm. Cap/Sh. Inv.	-33.8
Allianz RCM Biotech. D	-9.2	ProFds. USh. Sm. Cap Inv.	-32.6
ProFunds Biotech. Inv.	-9.0	ProFds. USh. Mid Cap Inv.	-28.3

INTEREST RATES

KEY RATES

	APR. 12	WEEK AGO
Money Market Funds	4.27%	4.25%
90-Day Treasury Bills	4.70	4.67
2-Year Treasury Notes	4.91	4.80
10-Year Treasury Notes	4.98	4.85
30-Year Treasury Bonds	5.06	4.90
30-Year Fixed Mortgage †	6.42	6.36

†BanxQ

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-
General Obligations	4.09%	
Taxable Equivalent	5.84	
Insured Revenue Bonds	4.16	
Taxable Equivalent	5.94	

THE WEEK AHEAD

PRODUCER PRICE INDEX *Tuesday, Apr. 18, 8:30 a.m. EDT* » Producer prices are forecast to have increased 0.4% in March as energy prices bounced back a bit. That's the median forecast of economists polled by Action Economics. The index plunged 1.4% during February. Excluding food and energy, wholesale prices most likely rose by 0.2%, following a 0.3% gain for the previous month.

RESIDENTIAL CONSTRUCTION *Tuesday, Apr. 18, 8:30 a.m. EDT* » Housing starts in March probably cooled down a little more, to an annual rate of 2.05 million. Starts in February posted a significant slowdown, to a yearly pace of 2.12 million.

CONSUMER PRICE INDEX *Wednesday, Apr. 19, 8:30 a.m. EDT* » March consumer prices for goods and services most likely increased by 0.3%, after edging up 0.1% during February. Minus food and energy, prices are expected to have grown by 0.2%, following a 0.1% rise.

LEADING INDICATORS *Thursday, Apr. 20, 10 a.m. EDT* » The Conference Board's index of leading economic indicators probably held steady in March. The February index slipped 0.2%, due in large part to a slowdown in housing starts and an increase in weekly jobless claims.

The *BusinessWeek* productic climbed to 270.4 for the wee Apr. 1, a 13.2% increase fror ago. Before calculation of tl week moving average, th improved to 271.9.

BusinessWeek or

For the BW50, more invest data, and the components of the production index vis www.businessweek.com/magazine

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ndex gives the starting page for a story or feature with a cant reference to a company. Most subsidiaries are indexed under own names. Companies listed only in tables are not included.

S) 13, 22,

en 82, 96
4
22
n's 48
re 10
eel Buildings

Online (TWX)

n Express
52
Bank 48
Worldwide 40
APL) 22, 58,

Worldwide 36
14
) 36

Capital 98
Nova Scotia 48
hilippe de
hild 82, 83
earns (BSC) 50
ele-Ventures 62
(BMET) 28
nancial (BMO)

2
(BA) 30, 44
ns &
ields 90
Consulting
18, 62, 76
Scientific (BSX)

& Stratton
90
Myers Squibb
78
King 28
om 58

sion Systems
36
a 42
3S) 22, 38

Cephalon (CEPH) 78
Cerberus Capital 48
Charles Schwab (SCH) 100
Chiron (CHIR) 20
Christie's 90
Chuck E. Cheese 16
CIBC World Markets (BCM) 50, 98
Cingular Wireless 42
Citigroup (C) 20, 48
Coca-Cola (KO) 16, 38
Constellation Brands (STZ) 82, 83
Cooper Owen 90
CVS (CVS) 108

D

Dell (DELL) 10, 76
Deloitte & Touche 50
Delphi (DPHIQ) 52
Delta Private Equity Partners 98
Direct Revenue 36
Direct Spotlight Media 38
DirecTV (DTV) 102
Ditto.com 36
Doblin 62
DuPont (DD) 78

E

E. & J. Gallo Winery 82
eBay (EBAY) 36, 90
ECC Capital (ECR) 50
E.C.S. International 36
Embraer (ERJ) 44
EnCana 46
Enron 13, 28

F

FedEx (FDX) 78
Fidelity Investments 100
Fieldstone Investment (FICC) 50
First Franklin (FFHS) 50
FirstPlus Financial 50
Ford (F) 38
Fox (NWS) 13, 22
Friedman Billings Ramsey (FBR) 46
Fuji Heavy Industries (FUJHY) 44

G

Gap (GPS) 13
Gartner 42
Gateway (GTW) 10
General Electric (GE) 48, 62
General Motors (GM) 48, 52, 102
GMAC (GM) 48
Goen Group 38
Goldman Sachs (GS) 42, 98
Google (GOOG) 22, 24, 36, 42, 62
Guidant (GDT) 28

H

Hain Celestial (HAIN) 102
H&M Hennes & Mauritz 14
Hard Rock International 90
Harris (HRS) 42
Harris Interactive (HPOL) 108
Harris Nesbitt (BMO) 50
HBO (TWX) 22
H.C. Wainwright 102
HDNet 22
Hermès 96
Hewlett-Packard (HPQ) 10
High Tech Computer 42
Home Depot (HD) 112
Honda (HMC) 24

I

IBM (IBM) 62, 76, 108
ICANN 16
IKBI 14
Inditex 14
Infoscitex 79
Infosys Technologies (INFY) 62
Intel (INTC) 58

J

JetBlue Airways (JBLU) 108
Johnson & Johnson (JNJ) 28
Johnson Controls (JCI) 52
JPMorgan Chase (JPM) 42

K

Katzenbach Partners 62
Kaufman Brothers 102
Kawasaki Heavy Industries (KWHIY) 44
Keefe Bruyette & Woods 50
Kohlberg Kravis Roberts 48

L

Lafon 78
LatinSource 46
Lear (LEA) 52
Loan Performance (FAF) 50
Long Beach Mortgage (WM) 50
Loomis Sayles 102

M

McGraw-Hill (MHP) 28, 100
Merck (MRK) 28
Merrill Lynch (MER) 28, 48
Microsoft (MSFT) 42, 58, 76
Mitsubishi Heavy Industries 44
Modeo 42
Moody's (MCO) 48
Motorola (MOT) 30, 42
MySpace.com (NWS) 28

N

NBC 38
NBCSearch 36
Necaise Brothers Construction 14
New Century Financial (NEW) 50
Newell Rubbermaid (NWL) 108
News Corp. (NWS) 28, 102
Nielsen Media Research 38
Nintendo (NTDOY) 40
Nokia (NOK) 42, 62
Northwest Broadcasting 13
Novartis (NVS) 20
NovaStar Financial (NFI) 50
Nucor (NUE) 30, 80

O

Occidental Petroleum (OXY) 46

P

Palm (PALM) 10
Pal's Sudden Service 16
Passfaces 79
Pernod Ricard 82
Perseus-Soros Bio Pharmaceutical Fund 102
PFC Energy 46
PodTraining 16
Procter & Gamble (PG) 62, 76

R

R&R Enterprises Autograph Auctions 90
Real Media 58
Red Rock Casino 94
Research In Motion (RIMM) 10, 42, 58, 62
Ricardo Beverly Hills 96
RT Strategies 34
Rubin Postaer 24

S

SafeHarbor Holdings 98
Samsung 10, 62, 76
Sana Security 36
Sanford C. Bernstein 52
Sanofi-Aventis (SNY) 78
Sears (SHLD) 38
Sony (SNE) 76
Sotheby's (BID) 90
Southwest Airlines (LUV) 62
Spencer Forrest 98
Sporting Bet 38
Standard & Poor's (MHP) 48, 76, 102
Starbucks (SBUX) 62, 76
Star Buildings 80
Starcom Entertainment 38
Station Casinos (STN) 94
Stone Yamashita Partners 62
Symbian 42

T

Target (TGT) 76
Teal Group 44
3M (MMM) 62, 76
Time (TWX) 98
TiVo (TIVO) 38
T-Mobile (DT) 42
Toyota (TM) 62, 76
Toys 'R' Us 48
Tradewins 30
Trend Micro (TMIC) 36
T. Rowe Price (TROW) 100

U

Unilever 38
USA Network 40

V

Valentis (VLTS) 102
ValueAct Capital 20
Vanguard Group 18, 100
Verizon Wireless 42
Viña Concha y Toro 83
Virgin Group 62
Vodafone (VOD) 42
Vonage 36
VoodooPC 10

W

Wachovia (WB) 48, 100
Wal-Mart (WMT) 28, 76
Walt Disney (DIS) 22, 28
Washington Mutual (WM) 50
Wolfgangsvault.com 90
WWE (WWE) 40

Y

Yahoo! (YHOO) 24, 36, 58
yet2.com 62
YourEncore 62

Z

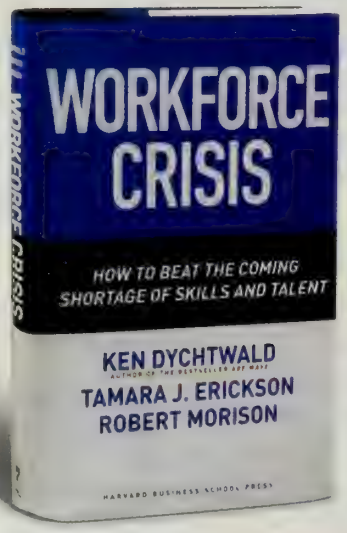
Zogby International 34

Take This Job and Customize I

WORKFORCE CRISIS How to Beat the Coming Shortage of Skills and Talent
By Ken Dychtwald, Tamara J. Erickson, and Robert Morison; Harvard Business School; 269pp; $29.95

Employers love young workers. They don't eat up health-care dollars. They're seen as energetic and malleable. And they're cheap to hire. No wonder companies seem so happy to wave goodbye to pricey old-timers, encouraging their exit through buyout packages and early retirement. But author Ken Dychtwald, along with management consultants Tamara J. Erickson and Robert Morison, argues that such thinking could soon imperil American business. The stereotypes of the young, eager worker and burned-out veteran, they believe, are utterly wrong. Moreover, by the end of the decade, companies could be scrambling to hold on to mature employees and be forced to rethink how to deal with every age group.

That's the premise of *Workforce Crisis: How to Beat the Coming Shortage of Skills and Talent,* a compelling book that outlines trends that could affect every corner of U.S. business. Dychtwald, a well-known pundit who usually writes upbeat works like *Age Wave* on how baby boomers will redefine aging, takes a more complex view of demographic trends here. He and his co-authors say that, in the wake of declining birth rates and with the growing evidence of the worth of older workers, companies should radically change how they view experienced talent. The issue isn't just a shortage of bodies but a potential loss of veterans' skills.



Luckily, many older employees don't really want to rush out the door. In their research, the authors found that mature folks often have higher levels of job satisfaction, productivity, loyalty, and enthusiasm than do their younger colleagues. Moreover, seasoned workers are less likely to job-hop, get torn apart by issues of work-life balance, engage in egocentric battles with colleagues, or suffer from burnout. What they do want, however, is meaningful work, recognition of experience, and a flexibility that will allow them to reduce or alter responsibilities at the sunset of their careers.

The most intriguing part of *Workforce Crisis* considers how companies should tailor the workplace to the needs of each of three cohorts: the over-55 crowd, the time-squeezed midcareer employees, and the fickle under-34 group. Among other things, the authors share the findings of a survey of 7,700 employees they asked Harris Interactive to conduct. They also look at how companies such as CVS, JetBlue Airways, IBM, and Newell Rubbermaid manage to woo and retain different age grou The book ends with a useful but less insightful section on mechanics of assembling work arrangements, training, a benefits to fit peoples' needs during different life stages.

The discussion of older workers covers terrain Dychtw has explored in previous books, such as the end of traditic retirement and the potential for such people to launch ne careers. Some may now be open to global assignments th they once shunned as a result of family responsibilities. O may blossom in mentoring or training jobs that tap their without requiring a full-time commitment.

Then there are the midcareer workers: Management o doesn't fret too much about the needs of th between the ages of 35 and 54. That shoul be the case, since some in this group may f growing frustration as their careers stall a they fail to move up into senior manageme Moreover, such workers may feel sandwic between obligations to kids and aging par while others may be trying to reenter the workforce after taking time off to raise chil Some, immersed in a midlife crisis, feel hu for change. Whatever the reason, employe this group often value flexibility and aid in meeting obligations. Fresh assignments a training can reinvigorate their careers. Th may crave more leadership opportunities, sabbaticals, or both.

Finally come the younger employees, w another set of concerns. In the authors' su this group emerged as the least satisfied a least engaged. They want respect, independence, sel defined work schedules, an challenging duties with sufficient compensation in or time off. Employers wh to keep them have to build engaging, friendly, and hig performance environment Empower young staffers, e them to different opportun and—perhaps most impor stay in touch with alumni and make it easy for them to re they leave to try out other jobs, the authors advise.

> To retain top talent, tailor work to fit the different stages of life

In the end, *Workforce Crisis* is less an analysis of an impending labor calamity than a smart argument abou benefits of customizing work to the needs of different g With continued immigration and delayed retirement, t talent shortage may never become a nationwide disaste companies that make efforts to retain people at every li stage are likely to snatch the top talent in any market. ■

–By Diane

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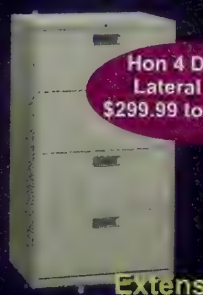

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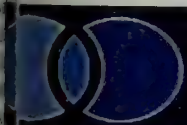

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IdeasOutside Shot

BY STEPHEN JOHNSON

The Best Immigration Reform

For the past decade, U.S. lawmakers have put off immigration reform because nobody could agree on how best to regulate the flow. They still can't, as Washington's recent sorry scramble to craft a fix attests. But the stark disparity between job opportunities and living standards in Americ and many poor countries has resulted in such an influx of undocumentec

aliens (now between 10 million and 12 million, more than half from Mexico) that Congress and the White House must act.

Success in controlling this tide certainly requires better border security, stronger workplace enforcement, and a practical guest-worker process to match prospective laborers with legitimate employment. Yet there's an equally important—but neglected—need. Labor-exporting countries must do more to provide employment opportunities and access to social mobility for citizens at home.

In Mexico's case, the good news is that sound fiscal policies, the North American Free Trade Agreement, and institutional reforms have kept lots of potential migrants from leaving. The bad news is that job growth south of the border hasn't been fast enough to absorb all the new entrants into the labor force.

Mexican Interior Secretary Carlos Abascal Carranza came to Washington recently with an economic progress report. That is a welcome change from the rhetoric that President Vicente Fox has spouted for the past five years: constant reminders that Mexico should have the right to export its surplus workers to the U.S.

Fox's first Foreign Secretary, Jorge Castañeda, pushed that absurd message without regard for America's sovereignty or Americans' sensitivities. No country exists to take on the problems of others. But internal conditions can have consequences that extend across borders. So it should come as no shock that the U.S. has an interest in Mexico's economic policies and performance.

Mexico's economy has, in fact, improved under Fox. From 2000 to 2005, annual inflation declined by two-thirds, foreign investment grew 74%, and the public deficit dropped to zero. Meanwhile, real wages rose 7%, the sum of Mexicans living under one poverty index fell 23%, 6 million scholarships now help keep more poor children in classrooms through high school, and nearly 577,000 jobs were created in 2005.

Still, almost a million youths enter the Mexican labor force each year. So a half million new jobs are simply not enough.

Stimulating growth south of the border will stem the tide of illegal aliens

Mexico's minimum wage is $4.50 per day, vs. the minimu $5.15 per hour stateside. And while more Mexican childre are attending school, the system is still centralized under inefficient national ministry and subject to periodic strike

Other net labor exporters in our hemisphere are even worse off. Guatemala and Honduras report poverty rates close to 75%. In South America's Andean ridge, from Venezuela to Bolivia, the poor constitute more than half c population. Except in Colombia, a developing trend is to consolidate power within populist presidencies, ignore th rule of law, and put business under government's thumb.

The result? Blocked from social mobility at home, Peru entrepreneurs already are choosing the U.S. haven for business startups. Ecuadorians ar stowing away in shipping containers to get the U.S. or Europe, while one of Venezuela's most popular Web sites continues to be www.mequieroir.com ("I Want to Leave").

Backsliding toward statist economies will make matters worse, forcing more workers t migrate. That's why the U.S. must urge its hemispheric neighbors to liberalize economi cut regulations, and allow prosperity to sprea more broadly across their citizenry. Mexico h gone partway. Fox's four-year-old Rapid Bus Start-Up System cut red tape for licensing so small firms from 50 days to just 24 hours. Bu inefficient state monopolies, high taxes, mas bureaucracy, and a rigid labor code still restrict job growth

U.S. officials should remind candidates for the Mexican presidency and congress this year that any retreat from fre market reforms will limit opportunities for Mexican work home and create friction between our nations. Beyond tha U.S. lawmakers should resist the temptation to adopt "silv bullet" reforms like building a border fence or embracing guest-worker program. While these two tacks may be part solution, they alone are not enough. To reduce unauthoriz immigration, U.S. policies must also seek reforms abroad

Stephen Johnson *is a senior policy analyst at the Heritage Foundation.*

Views expressed in Outside Shot are solely those of contributors.

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Ideas The Welch Way

BY JACK AND SUZY WELCH

Tough Guys Finish First

Do tough bosses really get more out of their people? Of course they get short-term results, but do they really help a company win in the long run?

–Alessandro Bolongaro, Milan

Yes and yes. But what a loaded question! Loaded because how you define "tough" matters a lot to the answer. And loaded, too, because how tough a boss seems may well depend on your own performance.

Look, tough is a multilayered term that is open to discussion. But there can be little debate about the fact that top performers with great results tend to worry and complain a lot less about tough bosses than those struggling to meet expectations. That may sound tough itself, but it's reality.

Let's talk about the meaning of tough. Without doubt, there are tough bosses who are nothing more than bullying, power-drunk jerks, and they're brutal to work for. They callously push their people, take credit when things go right, point fingers when they don't, and generally are very stingy with praise and rewards. They can also be moody, political, manipulative, secretive, outright mean, or all of the above. Now, as you say, sometimes these tough bosses get good results. But it's rarely for long. At any decent company, they are removed or they self-destruct, whichever comes first.

But bosses exist along a spectrum, and the destroyer-types we just described are at one far extreme. At the other end, and equally as damaging to the business, are the "Is everybody happy?" variety. Yes, they may be enjoyable to work for–getting paid was never so easy!—but their spinelessness typically translates into mediocre results. Why? At least three basic sins are at work: These "nice" bosses treat everyone with the same wimpiness, they explain away misses without meting out consequences, and they change direction according to the needs and wishes of the last person in their office. In a word, they have no edge.

> "Is everybody happy?" bosses are fun to work for, but wimps deliver mediocre results

Somewhere between the two extremes, and probably closer to the hard end than the soft, are bosses who define the notion of tough the right way, and because of that manage to get strong, long-term performance from their people. It is not going too far to say that such bosses are actually the heroes of business, not the villains. They might not make everyone feel warm and fuzzy, but their good results create a healthy, fair work environment where people and the company prosper, where there is job security for employees who perform well, and value for shareholders. What more could you want?

To these types of bosses, tough means tough-minded. They set clear, challenging goals. They connect those goals with spec expectations. They conduct frequent, rigorous performance reviews. They reward results accordingly, with the most pra and the highest bonuses going to the most effective contrib and commensurate compensation levels distributed down t line, ending with nothing for nonstarters. They are relentles candid, letting everyone know where they stand and how th business is doing. Every single day, good tough bosses stret people. They ask for a lot, and they expect to get it.

DOES THAT MAKE THEM hard to work for? Of course. But h where individual performance comes into play. If you're u the challenge, working for a tough boss can be incredibly energizing because you achieve in ways you never though could. But if a tough boss raises the bar to a point where are out of your league, then you're likely to hate the experience. And if human nature is any guide, chances ar won't blame yourself. You'll blame the "tough" boss.

A perfect example is Bob Nardelli, CEO of Home Depot good tough boss if there ever was one—demanding to be but fair, transparent, and results-focused. I recent *BusinessWeek* article assessing Bob's year turnaround at Home Depot (BW—Ma the usual "other side of the story" came in form of complaints from former company executives, who claimed that Bob had crea an oppressive "culture of fear." Note that executives, none of whom agreed to be identified, no longer work at the company have to wonder why they left. Was it becau Bob was too "tough"? Or was it because h tough-mindedness created performance standards they could not meet?

We bet on the latter. The point is: There good tough bosses and bad ones, and whi which is often in the eye of the beholder. we're not talking about the egregious cases of jerk bosse berate and belittle their people. Everyone hates them, ar they deserve universal loathing.

We're talking about bosses who operate in the middle ground—bosses who are tough but fair, push hard but r in equal measure, and who give it to you straight.

Weak performers usually wish these bosses would go People who want to win seek them out. ■

Jack and Suzy Welch are co-authors of the best-seller Winning *(HarperCollins 2005). They look forward to answering your questions about business, company, or career challenges. Please e-mail them at* **thewelchway@businessweek.com.**

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